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EFFECTS ON POVERTY ALLEVIATION OF STRUCTURAL ADJUSTMENT PROGRAMMES, JOB CREATION POLICIES, AND MEANS FOR THE PARTICIPATION OF SMALL-SCALE AND MICRO-ENTERPRISES IN INTERNATIONAL TRADE

The role of small and micro-enterprises in poverty alleviation through participation in international trade

Background note by the UNCTAD secretariat

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EXECUTIVE SUMMARY

1. This note assesses the export potential of the small-scale sector in the developing countries with emphasis on the issue of employment creation for the poor. A number of policies are proposed which could be instrumental in easing the main constraints on the sector's capability to expand exports.

2. The small-scale sector has been defined as enterprises employing up to 50 persons and operating in rural and urban non-agricultural activities. However, the sector is far from being homogeneous. In terms of responsiveness to government policies, a distinction can be made between formal and informal sector enterprises. The main implication of the different legal status of enterprises is that, in practice, the informal sector cannot generally be reached and assisted by standard government policies designed for the formal sector.

3. Shrinking employment opportunities in the large-scale sector, especially public sector enterprises, have refocused the attention of policymakers on the small-scale sector and its contribution to gainful employment. Its high capacity to absorb labour, low skill requirements and use of labour-intensive techniques have been pointed out as being well-suited for generating employment for the poor.

4. Low demand in the domestic market of the developing countries has also given rise to the question of the possibilities of small-scale enterprises in the export sector. Even if most of them lack the capacity to export, there is a considerable untapped export potential within the sector. The small-scale sector's competitive edge is in low prices resulting from low labour costs, flexibility and ability to fill small orders or produce small quantities of products. Three types of enterprise can be reasonably supposed to have good export prospects: (a) small formal enterprises engaged in standardized manufactures' production, (b) micro-enterprises operating in handicrafts, and (c) micro- and small informal enterprises involved in making standardized products through, *inter alia*, subcontracting from larger enterprises.

5. The small-scale sector's performance in international trade has been adversely affected by a number of problems. Two types of constraints can be identified: (i) the constraints that are internal to the small-scale sector enterprises themselves and which result from the lack of entrepreneurial capability and skills, from the low quality of products, etc.; and (ii) the constraints that are external to this sector, namely unfavourable national policies and protectionist measures reducing access to export markets.

6. The main scope for government policy measures appears to be in providing not only durable macroeconomic policies but also direct support measures to this sector. Employment-inducive and at the same time export-promoting growth strategy may eliminate the anti-export bias and facilitate the participation of the small-scale sector in international trade. The recent wave of trade policy reforms introduced by many developing countries in the 1980s is an important step in this direction. Available studies show a rise in export performance in the late 1980s, in particular in labour-intensive manufactures largely produced by the small- and medium-scale sectors.

7. Measures targeted to support the small-scale sector in international trade are needed in addition to the use of macroeconomic instruments. Direct measures that could be adopted include: (i) strengthening the export marketing capability of the sector (through, for example, assistance in quality control; access to appropriate technologies, packaging and marketing; provision of training courses etc.), and (ii) facilitating access to credit for small-scale activities. In analysing government measures in this field, however, an important fact to be kept in mind is that there is scope for the small sector to assist itself (e.g. through professional associations), and for foreign partners (customers) to help in upgrading the small-scale sector's export potential.

8. Improved access to developed countries' markets is another issue, which is crucial for the success of small-scale sector exports. Concerns about rising unemployment in most developed countries do not facilitate the efforts required for easier access of labour-intensive products from developing countries. Despite existing problems, however, these efforts should continue to be pursued. Diversification of exports - from traditional and sometimes sensitive items to non-traditional products less vulnerable to protectionism - would also be an option for developing countries in this case. The ideal would be, however, to work towards achieving balanced trade in the framework of increasing interdependence between developed and developing countries.

INTRODUCTION

9. The important role that can be played by the small-scale sector in alleviating poverty has been singled out because of its potential to generate employment and income for the poor. Deteriorating economic conditions in the developing countries since the beginning of the 1980s have directed attention to the possibility of expanding employment creation opportunities by this sector through export-oriented activities.

10. This note addresses the question of employment creation for the poor through greater participation by the small-scale sector in international trade. Its main objectives are: (a) to assess the small-scale sector's export potential; (b) to identify the types of enterprise that are likely to succeed in international markets; (c) to analyse the major constraints facing export-oriented enterprises; and (d) to discuss the policies that may improve the sector's export record and create new employment opportunities. Some policy measures are suggested at the end of this study.

I. POTENTIAL OF THE SMALL-SCALE SECTOR FOR EMPLOYMENT CREATION AND EXPORTS

A. Basic concept of the small-scale sector

11. The small-scale sector is generally understood to mean those enterprises employing up to 50 persons and operating in rural and urban non-agricultural activities, for example, in manufacturing and services. However, this particular definition is rarely reflected in statistical data. Small-scale enterprises are frequently grouped together with medium-sized enterprises (i.e. those employing from 51 to 100 persons) under the label of small and medium-sized enterprises (SMEs).

12. In order to understand better both the advantages and the constraints facing small-scale enterprises we begin the discussion in this section with a classification of the small-scale sector. Two types of classification seem to be relevant for the purpose of this study, namely (a) according to the size of an enterprise, and (b) according to the legal status of an enterprise.

13. With respect to the first classification in which size is the decisive criterion, two groups of enterprises can be distinguished: (a) **micro-enterprises** employing between 2 and 10 persons (this category also includes self-employed individuals who constitute the overwhelming majority), and (b) **small enterprises**: employing between 11 and 50 people.[1/]

14. A number of other differences between the micro- and small enterprises can be identified, although sometimes the dividing line is not completely clear. Table 1 below gives some of the salient features of micro- and small enterprises.

Table 1

Differences between small and micro-enterprises

Criteria	Micro-enterprises	Small-scale firms
Employment structure	Owner and family members	Employment of workers in addition to owners.
Education	High percentage of illiterate (especially among women), mostly "on-the-job" training.	Longer formal schooling; more frequent formal training.
Financial resources	Mostly internal (personal savings, family sources) or reliance on money lenders	Use own resources but to some extent also formal (external) resources.
Rural/urban setting	House, backyard, open air	Regular workshops.
Use of public services (water, electricity, telephone)	Very rare	More frequent.
Inputs	Locally-available and often recycled	Higher proportion of imported inputs.
Technology	Mostly traditional; use of hand tools, high labour-intensity	Often modern, upgraded, use of machines.
Products	Low quality, rough finishing	More attention to quality and packaging.
Markets	Mostly low-income local consumers, medium to large enterprises	Local low- and middle-income consumers, some larger enterprises and export markets

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1/ Data collected by Liedholm and Mead (C. Liedholm and D. Mead: *Small-scale Industries in Developing Countries - Empirical Evidence and Policy Implications*, USAID, Washington, D.C., 1986) on industrial employment demonstrate that the bulk of jobs is provided by micro-enterprises (for example, 83 per cent in Zambia, 1985, 66 per cent in the Philippines, 1974, 65 per cent in Vanuatu, 1990).

15. In terms of policy considerations, the second classification seems to be crucial, namely the division of small-scale enterprises according to their **legal status** into formal and informal sectors: **formal sector** enterprises are registered with the authorities, whereas the **informal sector**[2/] enterprises are not; they are therefore not legally recognized and hence are officially non-existent. Nearly all micro-enterprises, and some small enterprises as well, fall into this category. In fact, each of these sectors tends to operate in a fundamentally different legal setting which determines its responsiveness to government policies. Major differences between the two sectors are summarized below in table 2, with an assessment of the advantages (indicated by +) and disadvantages (as -) which any particular component of formality/informality brings to enterprise competitivity.

Table 2

Advantages/disadvantages of formality/informality

	Informal sector enterprises		**Formal sector enterprises**
+	Do not pay taxes	-	Pay taxes (depending, however, on the enforcement capacity of the government).
+	Are not subject to government regulation (especially in terms of labour legislation, such as minimum wages)	-	Have to comply with government regulations.
-	Unable to use formal institutions such as banks, marketing boards, training facilities, etc.	+	Able to contact formal institutions (apply for bank loans, premises, electricity).
-	Unable to profit from government assistance	+	Have access to government assistance schemes, both general and those designed for small-scale sector (concessional finance and services, tax allowances, etc.).
-	Cannot export and import on their own. Usually need the intervention of intermediaries.	+	Can carry out foreign trade operations on their own.
-	Have no influence on government policies as they are not organized.	+	May be able to exercise some pressure on government (through professional associations).

2/ According to estimates (OECD, *Development Co-operation - 1991 Report* (Paris, 1991) p. 70) the informal sector accounts for between 30 and 70 per cent of the economically active population in the developing countries (its share is over 60 per cent of the labour force in Africa, from 50 to 75 per cent in Latin America, and from 10 to 20 per cent in the NICs in East and South-East Asia (Economic and Social Council, *World Summit for Social Development*, Report of the Secretary General (E/1993/77), 1993, p.19).

16. Contrary to general expectations, most informal enterprises tend not to grow into formal ones. This is due to a set of complex social, political and economic reasons, such as the lack of potential for development (e.g. due to an inability to accumulate capital or to the lack of motivation to become formal because the advantages of informality may, in the entrepreneurs' perception, outweigh the disadvantages). In some cases, enterprises may well opt to remain informal for fear of losing their competitive edge in well-established or "niche" markets.

B. Potential of the small-scale sector for employment creation

17. The economic policy of many developing countries has long been based on the belief that rapid development could best be achieved by emulating what were perceived to be the industrial structures of the developed countries, i.e. structures based on capital-intensive large-scale industries. By the mid-1970s, however, this strategy was increasingly questioned as a result of the poor performance of these industries and the protection awarded to them. Large enterprises, in both the private and public sectors, which operated in a protected environment, often proved to be inefficient. In addition, the employment-creation objectives vested in them were rarely achieved.[y] This was largely due to their economies of scale and government policies that encouraged capital-intensive patterns of production.

18. For these reasons, it is now widely recognized that the large sector will, in principle, be unable to generate sufficient employment for the expanding labour force in developing countries. In this context, the small-scale sector is being viewed as a means to mitigate the employment crisis and to promote more equitable distribution of income. There are three reasons for this point of view. First, while, in developing countries, medium- and large-scale enterprises dominate in terms of value added, the small-scale sector leads in the share of persons employed. Second, it shows higher capacity to absorb additional and dismissed workers. Thus it offers a valid alternative to the shrinking opportunities available in the large-scale sector during recession and structural adjustment. Third, low-skill requirements and the use of labour-intensive techniques make the small-scale sector particularly well-placed for employing the growing numbers of the poor.

C. Export potential of the small-scale sector

19. The small-scale sector has been drawing increased attention because of its employment-generating capacity. However, any increase in production (and employment) in this sector is seriously hampered by what the entrepreneurs themselves identify as a main constraint to the development of their activities -

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[y] See, C. Liedholm and D. Mead, *Small-scale Industries in Developing Countries - Empirical Evidence and Policy Implications*, MSU International Paper No.9, Michigan State University, East Lansing, Michigan, 1987. Some argue, however, that higher labour intensity cannot be automatically identified with the small-scale sector. According to them, the size of the enterprise apparently proves to be irrelevant and what really matters is the technology employed. (W. Elkan, *Policy for Small-scale Industry - A Critique*, Background Paper for the *1987 World Development Report.*)

i.e. the problem of insufficient demand in the domestic market.[4] In this context, a possible strategy may be to exploit the potential competitive advantage of small-scale producers from developing countries and to export their products to developed-country markets,[5] thus augmenting production by selling both in foreign as well as domestic markets.

20. In order to assess the feasibility of such an approach, it is useful to examine the various factors behind the small-scale sector's competitiveness, to evaluate their relevance for its export capability, and to identify those enterprises within the small-scale sector that would have the potential to export successfully.

21. The main factors behind the small-scale sector's competitiveness and their impact on the capability to export are summarized in table 3 below:

Table 3

Factors contributing to the small-scale sector's international competitiveness

Factor	Relevance to international competitiveness
Greater flexibility (than larger units)	Yes.
Production of small sets of products	Partly, particularly for those with labour-intensive technologies.
Use of domestic resources	Partly, if they are cheaper than imported resources.
Use of traditional skills	Partly, if they are needed for the production of specific items, such as handicrafts.
Proximity to markets	No.
Low prices resulting from low labour costs	Yes.

22. In terms of international competitiveness, two of the above-mentioned factors are particularly relevant, namely the low prices of the finished products and the greater flexibility of small-scale sector enterprises. The latter is particularly important in determining competition in international markets. Yet, many policymakers still hold that the small-scale sector's competitiveness is

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[4] However, recent developments (real devaluations resulting in an increase in prices of importables) seem to boost the demand for the small-scale sector's products and services. More opportunities have appeared in (a) repairs and maintenance of ageing imported consumer durables and plant equipment and in (b) the substitution of simple tools and appliances or consumer goods produced locally for those that used to be imported.

[5] As available evidence on export possibilities in other developing countries' markets for labour-intensive goods made by small-scale producers is very scarce, this note will focus exclusively on access to developed countries' markets.

due to low prices resulting from low labour costs.[6] The best prospects for exports are therefore to be seen in **low-skill, domestic-resource-based and labour-intensive products.**[7] Based on factor content in goods, the most appropriate categories in terms of job creation (i.e. for unskilled labour-intensive products) and export prospects are textiles, clothing, leather, footwear, wood and cork, furniture and fixtures, printing and publishing, some pottery and glass products, some metal and non-metallic products, and food products.[8]

23. Any assessment of the small-scale sector's export potential has to take into account the fact that the majority of enterprises will never be able to participate in international trade. Two reasons can be mentioned in support of this statement. First, available case studies in the informal sector[9] show that approximately 75 per cent of those employed in this sector work in services (for example, as messengers, street vendors, servants, rickshaw drivers, shoeshine boys, etc.). Despite the fact that they represent jobs, such activities have no export potential. Second, a large proportion of manufacturers produce cheap, low quality goods that substitute for more sophisticated items produced by the formal sector or imported from abroad. Such goods attract few, if any, customers in the developed world, where the level of consumption is higher.

24. Despite the fact that the small-scale sector's export potential is limited, there are certain types of enterprise that have good prospects in international markets.[10] Three groups can be identified:

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[6] As a matter of fact, there is a substantial difference between developed and developing countries as regards labour costs in labour-intensive industries, which puts producers from developing countries in a good competitive position for exports. According to UNIDO data (calculated on the basis of UNIDO, *Handbook of Industrial Statistics, 1992*, p.38), labour costs (wages per employee per annum) were on average 4.5 times lower in developing countries than in the developed part of the world in 1988 in the food industry (20 times lower in Bangladesh, India, Indonesia, Sri Lanka and Malawi), 4 times lower in textiles, wearing apparel, leather products and footwear, 5.3 times lower in wood and cork products, plastics and pottery. However, the cost advantage in favour of developing countries is partially offset by the lower quality of the products and by the inverse difference in productivity. UNIDO data suggest that the value added per employee per annum is up to three times higher in developed than in the developing countries throughout labour-intensive manufacturing industries.

[7] However, new technologies are increasingly challenging the "cheap labour" hypotheses of conventional theories about the international division of labour.

[8] See, F. Senses, "The nature and main characteristics of recent Turkish growth in export of manufactures", *The Developing Economies*, XXVII-1, p.33.

[9] H.-R. Hemmer, "On the economic analysis of the urban informal sector", *World Development*, No.10/1989, p.1544.

[10] The role of the small-scale sector in exports, though generally small or non-existent in most developing countries, has been growing in parts of Asia and, to a lesser extent, in Latin America. The areas where this is occurring consist mainly of (a) countries with an established or growing record in export orientation (e.g. Brazil, Chile, China, Hong Kong, Republic of Korea, Taiwan Province of China, etc.); (b) certain countries where foreign direct investment is substantial (e.g. China, Malaysia, Mauritius, Mexico, Singapore, Thailand, etc.), and (c) some cases of government-supported export efforts (e.g.India).

1. **Small modern enterprises (formal)**

25. These enterprises are able to profit from both low labour costs and generally higher technology and quality to be competitive in the production of standardized manufactured products or in subcontracts to larger enterprises. In these cases, more durable and regular relationships with customers are the rule. Country studies from Peru, Ghana, Mexico, India and Indonesia,[11] assessing the prospects of small-scale sector enterprises according to their size and technological background, provide support for the argument that the best prospects lie in particular with the relatively larger, technically more advanced and export-oriented enterprises.

2. **Micro-enterprises operating in handicrafts (informal)**

26. Low labour costs and the use of traditional skills are the main determinants of the micro-enterprises' competitiveness in handicrafts. A competitive price as well as the perception of these products by foreign customers as expressions of a particular culture and tradition have largely contributed to the success in expanding exports of clothing, leather products, wood carvings, carpets, metal work and jewellery by India, Sri Lanka, Kenya and others.

3. **Micro- and small enterprises engaged in standardized production (informal)**

27. New prospects appear to have opened up for informal enterprises as a result of growing competition in international markets, leading to more flexible patterns of production (smaller orders, just-in-time deliveries) and the search for reduced costs. "Putting-out" systems are frequently used: micro-enterprises become subcontracted labour-intensive operations (for example in the garment or footwear industries). Orders are placed by large enterprises, including multinationals, but only after export contracts have been concluded. This pattern of relationship increases the flexibility of large enterprises and, of course, cuts costs.

28. While it is true that small and micro-enterprises' export efforts are frequently hampered because they are too small, and hence unable to operate efficiently to reach foreign markets on their own, there has been a growing trend for small units to increase their competitiveness by creating **industrial clusters**. Similar in some aspects to the Italian model of industrial districts, these clusters have performed very well in a number of developing countries (e.g. Brazil, India, Indonesia, Kenya, Peru, Republic of Korea, Rwanda and others[12]). Small enterprises, in such circumstances, have tended to organize business networks of geographically concentrated firms operating in a specific industrial sector. The firms are linked with each other through subcontracting arrangements and a set of common social links and values. These industrial clusters have proved very useful in fostering competitiveness. In particular, they have

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[11] Cited in K. Nadvi, "Industrial district experiences in developing countries", Background Paper for the UNCTAD/GTZ symposium on "The Role of Industrial Districts in the Application, Adaptation and Diffusion of Technology", Geneva, 1992.

[12] For details, see, for example, K. Nadvi, *op.cit.*, or H. Smitz, *Small Enterprises and Fordist Giants - Tale of a Supercluster*, Discussion Paper No.331, Institute of Development Studies, 1993.

greatly facilitated: (a) the loan or renting of tools and equipment, (b) subcontracting to neighbours when a large order is secured, (c) sharing general information on new or improved products and technology (yet keeping specific information for themselves and competing with each other), and (d) attracting customers as a result of the concentration of similar activities in close proximity.

II. MACROECONOMIC MEASURES TO SUPPORT THE SMALL-SCALE SECTOR IN INTERNATIONAL TRADE

29. The small-scale sector's record in general, and in international trade in particular, depends largely on the presence of economic growth and on the type of growth strategy adopted. Economic growth creates new markets and the growth strategy determines the basis of this growth, including the kinds of technologies, markets and enterprises that are encouraged.

30. Recent experience suggests that macroeconomic policy is crucial for the long-term and viable development of the small-scale sector. It is argued[13] that indirect macropolicy interventions may do more to promote small industries than the direct measures prevailing in the past. This view is based on the assumption that entrepreneurs will respond better to market signals, particularly if market failures are redressed. Despite the limited empirical evidence on this issue, an attempt is made below to assess the impact of macroeconomic policy measures (adopted in the framework of export-oriented trade policy reforms introduced by developing countries since the 1980s) on the position of the small-scale sector vis-à-vis international trade.

A. Implications of trade policy reforms for the small-scale sector

31. Any assessment of the impact of trade reforms on the small-scale sector is hampered by the lack of statistical data and by analytical difficulties. First, markets are often not very well developed in many developing countries, with persisting distortions and market segmentations. Second, a large part of the small-scale sector is often not well integrated into formal markets. Third, by definition, the informal sector operates outside the officially recognized formal legal, fiscal and institutional frameworks. For these reasons, therefore, market signals and **government policies** may probably **not affect** the small-scale and, in particular, the **informal sector directly**. The indirect effects of macropolicies on informal enterprises can work through (i) the interaction with economic operators in the formal sector, and (ii) the policies that were not originally targeted to this sector.[14] For these reasons the expected positive results of national macroeconomic policy measures may never materialize.

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[13] See W. Elkan, *op.cit.*.

[14] For example, in many African countries, scrap metal used by small metalworkers consists largely of fragments of steel left from large-scale formal enterprises. Thus, in case where imports of steel are curtailed following adjustments in the exchange rate, informal enterprises can face serious bottlenecks in the supply of scrap metal.

1. Exchange rate policy reform

32. **Real devaluations** have helped in many cases to eliminate overvaluation-related distortions and the bias against exports and small, labour-intensive enterprises. On the side of imports, devaluations raise the domestic price of imported products. This may have twofold consequences for the small-scale sector. On the one hand, the higher price of imported goods puts them out of the reach of a number of customers and may consequently lead to a shift of demand towards domestically produced and cheaper substitutes (indirect impact of devaluation). This is especially true when the small-scale sector production is based on locally available inputs. The substitution effect should encourage firms with high proportions of domestic input, generally to be found among smaller enterprises. For example, evidence from Ghana suggests that recent devaluations have boosted the demand for small-firm products and have encouraged them to enter new product lines.[15/]

33. On the other hand, however, prices of both new and second-hand machinery imported from abroad tend to rise, hampering technological progress in the small-scale sector. In the case of a dependence on imported inputs, small enterprises may see their competitiveness falling on both the domestic and international markets (even though they are likely to be less affected than large, more import-dependent enterprises). In United Republic of Tanzania, for instance, the incentives to domestic exporters resulting from the 70 per cent devaluation from 1987 to 1990 were rapidly offset by the escalating cost of essential imports.[16/]

34. The second effect of devaluation works through a positive impact on exports. Domestic goods may gain a competitive edge in international markets and give a strong impetus to exports, including those originating from small production units. However, devaluations that do not reflect fundamentals might be difficult to justify or maintain in a highly competitive and managed international trading system.[17/]

2. Trade liberalization

35. The evidence concerning the impact of trade liberalization on the small-scale sector is scarce since little or no attention has been paid to the size of enterprises when considering trade liberalization issues. An attempt at drawing some conclusions can nevertheless be made. Some studies[18/] do show that trade liberalization measures (both in export regimes and in exchange rates) have

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[15/] See, T. Tesfachew: "Government policies and the urban informal sector in Africa", Working Paper, *World Employment Programme Research*, ILO, Geneva,1992, p.11.

[16/] "Tanzania: Difficult road of reform", *Africa Recovery*, vol.4, No 2, United Nations Department of Public Information.

[17/] For example, under-valuation of the currency may be considered as a form of dumping.

[18/] For example, V. Thomas, J. Nash and Associates, *Best Practices in Trade Policy Reform* (Oxford University Press for the World Bank, 1991); or J.N.Bhagwati, *Anatomy and Consequences of Export Control Regimes* (Cambridge, Ma., Ballinger Publishing Co., 1978).

generally encouraged export performance. Export booms have been mostly based on exports of manufactures growing at rates exceeding those of the export sector as a whole. As labour-intensive items form a considerable part of developing countries' exports it can reasonably be assumed that trade liberalization can be beneficial to small-scale enterprises engaged in export activities.

36. On the import-competing side, the implications do not seem to be so clear cut. The main losers have evidently been the large-scale enterprises confronted with increasing competition from imported goods resulting from the removal of protection. Some small-scale sector enterprises engaged in the production of import-substituting goods may also have been adversely affected by increased competition from abroad, particularly in the case of consumer goods. There is some evidence,[19/] however, to indicate that import competition is largely a problem for big firms, since small ones see other local small firms as their primary source of competition. At the same time, lower tariffs should reduce the prices of imported inputs, including capital equipment used by small and micro-enterprises. The elimination of quantitative restrictions should also widen access to imports beyond the large-scale firms that are usually favoured by the import licensing system.

37. It has been argued that trade reforms would have generally positive effects on employment in the small-scale sector for two reasons. First, a pattern of production in line with a country's comparative advantage would result in a higher share of relatively labour-intensive goods in total output. Second, the relative price of labour-to-capital would adjust to market levels and, if the labour supply was abundant, give incentives to the employment of more labour-intensive techniques.[20/] Since the labour-intensive goods produced by the small-scale sector would be more competitive and could sell better in international markets, the demand for labour should rise, especially for the unskilled workers who prevail among the poor, in order to increase exportable output. In Malaysia, for instance, export policies have induced a significant expansion of employment in labour-intensive manufacturing sectors such as textiles, industrial machinery and parts and assembly-based electronics. In Morocco, increased exports of textiles, clothing and leather products[21/] have given rise to additional employment creation which has been concentrated in small formal sector businesses.

38. On the other hand, however, trade liberalization could favour even more the larger enterprises that are able to benefit from economies of scale. In this case, the small-scale sector - despite its low labour costs - might not be able to compete because of low productivity. This argument applies in particular to the production of standardized goods where economies of scale are important. Handicrafts would be less vulnerable.

19/ See, World Bank, *Small Enterprises in Ghana: Responses to Adjustment* (Washington, D.C., 1990).

20/ See, G.T. Renshaw, "Market liberalization, equity and development", ILO, Geneva, 1989, pp.118 and 124.

21/ See, F. Bourguignon and Ch. Morrisson, *External Trade and Income Distribution* (OECD, Paris 1989), p.117.

B. Relevance of export promotion measures to the small-scale sector

39. It is recognized that although sound macroeconomic policies and trade liberalization eliminate anti-export bias, they are not a *sine qua non* for efficient export expansion by the small-scale sector. However, it is argued that policies that aim at creating a neutral environment for the choice between production for the domestic market and for exports might not by themselves bring about export expansion. Measures biased in favour of exports have therefore often been suggested. These include access to imported inputs at international prices, export subsidies, better access to finance for exports and improved infrastructure for exports.

40. Traditional export promotion measures are unlikely to have any direct impact on informal sector enterprises, since most of this sector is not eligible for government export incentives. The small-scale sector may, however, benefit indirectly if formal intermediaries use the benefits related to government export schemes to encourage their informal suppliers.

41. Small formal enterprises in most developing countries are in principle entitled to apply for concessions provided by export promotion schemes. The difficulty is, however, that regulations and administrative costs governing export incentives are often designed in such a way that the benefit accrues mainly to large enterprises. Moreover, the lack of information on credit facilities available in this area to small units may preclude small enterprises from making better use of government export promotion programmes.

42. It should be kept in mind that in most cases policy instruments have been generally designed to promote exports as a whole and rarely take into account the specific needs of the small-scale sector. Hence, further measures are needed to target government export promotion policies explicitly towards the small-scale sector.

III. TARGETED MEASURES TO SUPPORT THE SMALL-SCALE SECTOR IN INTERNATIONAL TRADE

43. The small-scale sector has for a long time been perceived as lacking export potential. The output of micro- and small enterprises was generally conceived to be of low quality and attractive only to a highly localized segment of the domestic market and to tourists in the case of handicrafts. For this reason, State support to exports has tended to concentrate on "prospective" large enterprises and hardly any attention has been paid to small businesses. Government-sponsored programmes (provided by various small and medium-sized enterprise development agencies[22]) for small-scale activities were therefore restricted to general support measures, without a link to exports.[23] At the same time, export promotion bodies established to develop the capacity of national enterprises specifically for exports have not paid special attention to the small-scale sector.

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[22] Assistance is rarely centred on a particular segment of the small-scale sector (with the exception of handicrafts development agencies).

[23] However, there are also countries that have been implementing long-lasting programmes of small-scale sector promotion in exports (such as Morocco, Tunisia and some countries in South-East Asia).

44. As a result of the growing awareness of the existence of untapped export potential in this sector, export promotion has become a part of the small and medium-scale enterprise development package.[24]

45. With the above in mind, State support should (a) extend concessional financial assistance to export activities, and (b) strengthen the export marketing capability within the small-scale sector. It is recognized, however, that the small-scale sector and micro-enterprises will have to bear the major responsibility for generating exports.[25] A role would also be played by foreign customers.

A. Improving access to export finance

46. A major hurdle for the small-scale sector is access to finance. The financial services that are available are usually oriented towards the large-scale sector, so that even small formal enterprises have difficulty obtaining credit. Informal enterprises do not have direct access to the banking sector and rely mainly on money lenders and other informal sources for financing, often at much higher cost.

47. In this context, special measures (*inter alia*, those discussed below) may be considered not only by governments but also by external agencies to ease the export credit constraint, either directly or indirectly. First, the activity of government agencies acting as intermediaries should be encouraged, as well as that of export houses selling the small-scale sector's output in foreign markets. Access for these intermediaries to bank advances would be helpful to facilitate exports as the money could be channelled through them to the small-scale sector.

48. Second, the requirement for collateral by financial institutions could be replaced by the provision of government-supported guarantees or insurance. For this purpose, pre-shipment export finance guarantee schemes could be introduced by governments to replace physical collateral. For example, the Korea Credit Guarantee Schemes and the Export-Import Bank of Korea provide this type of

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[24] In this context, specialized agencies to promote exports of small and micro-enterprises have been established in some developing countries (China, Colombia, Ghana, Guatemala, India, Indonesia, Lao People's Democratic Republic, Nepal, Pakistan, Philippines, Somalia, Thailand, United Republic of Tanzania, Viet Nam and Zambia); their records vary, however. The packages of assistance to develop export-oriented small-scale sector enterprises are sometimes offered by existing small and medium-sized enterprise development agencies or export development agencies as well. In some cases, both of them work together to encourage small enterprises to export.

[25] An example of growing awareness of this fact is the creation by small producers of a wide range of **sectoral and business associations**, mostly found within industrial clusters. Such associations provide members with various services (which may be alternatively offered by State agencies) aimed at raising the sector's competitive edge in international markets and ranging from consultancy to the creation of export consortia or technical centres for quality control. Sectoral associations seem to be very efficient in Latin America or Cyprus, for example, but their range of activities covers only small modern enterprises producing standardized goods (garments, footwear, furniture, etc.) and apparently have no direct links to the informal sector.

guarantee.[26] In Chile, small producers of non-traditional exports can obtain a guarantee from the Guarantee Fund for Non-Traditional Exports for loans covering working capital requirements.[27] At the subcontractor level, simple procedures for obtaining bank loans using purchase orders or letters of credit as collateral could be helpful to small enterprises. At the artisan level, NGOs, cooperatives and rural banks, as well as commercial banks, could be encouraged to provide small credits by using innovative forms of guarantee such as, for example, collective responsibility.

49. Third, in order to strengthen the small-scale sector's competitiveness in export markets and its capacity to offer attractive terms to importers, it would help to provide pre- and post-shipment export finance on concessional terms. In India, for example, subsidized credit is in principle available for most exporters of manufactures, including small producers. In addition to pre- and post-shipment credit, small producers can also obtain subsidized bank loans for working capital. For handicrafts such as carpets, gems and jewellery, these loans may be equal to as much as half the value of the export order, at an interest rate of 3 to 5 percentage points below the prime lending rate. The problem is, however, that many exporters are considered by the banks to be too small or too risky and are therefore excluded from the scheme.[28]

B. Identifying exportable products

50. It is generally accepted that developing countries have a competitive advantage in labour-intensive production. Because of the relatively high costs of labour in the OECD countries, and rising wages in newly industrialized economies, a window of opportunity exists for low-labour-cost developing countries to enter international markets in the production of labour-intensive products. Niche markets for these countries exist, for instance, as we have seen, in specialized garments, leather-based goods, wood and rubber-based products, hand-made jewellery, electronics, precious stones and fruit juices.

51. The capability to fill niches in international markets is partly determined by technological developments, as consumers' preference is shifting towards quality rather than price. Within the technological choice, a question is whether the use of labour-intensive techniques in small enterprises is economically well-founded or whether more capital-intensive technologies are inevitable once enterprises export to more demanding markets. It seems that efforts to move up-market are increasing the demand for modern equipment, opening up job opportunities for higher-qualified installation and maintenance personnel, and therefore creating fewer jobs for poor and unskilled workers. Apart from subcontracting arrangements, such trends also imply a diminished role in exports for the small-scale sector, given the economies of scale inherent in larger enterprises.

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[26] International Trade Centre UNCTAD/GATT, *Exports from Small and Medium Enterprises in Developing Countries: Issues and Perspectives* (Geneva, 1989), p.131.

[27] See, L. Henríquez Amestoy: "Chile - experiencia exportadora de las impresas pequenas y medianas", *Comercio exterior*, No.6, June 1993, p.549.

[28] See, V. Cable, A. Weston and L.C. Jain, "The commerce of culture - Experience of Indian handicrafts", *Lancer International*, New Delhi,1986, p.209.

52. Concern has been expressed that labour-intensive technologies may be too inefficient and cannot meet the quality requirements of importers, thus making it difficult to compete in international markets. Studies carried out by the ILO[29] conclude, however, that some technologies requiring high labour inputs are cheaper than capital-intensive alternatives, while being efficient and producing goods of adequate quality. Both the objective of competitiveness and that of employment creation can be achieved with the use of such technologies.

53. However, there are factors that impede a broader proliferation of these labour-intensive yet efficient technologies. These include: (a) lack of information about possible technological choices, (b) misconceptions about labour-based methods, based on the belief that modern, capital-intensive techniques are the only means of improving quality and efficiency, and (c) lack of attention in research and development in developing countries to the development of suitable labour-intensive technologies. Technological change aiming at greater efficiency (and employment creation) ought therefore to be promoted to the utmost extent possible.

54. One possibility is to try to upgrade traditional technologies that are no longer efficient or competitive.[30] Another is to promote research on alternative-employment-creating competitive technologies. Thirdly, it would help to improve the access of small enterprises to information about appropriate labour-intensive technologies in use in other parts of the world.

55. Labour-intensive technologies, however, cannot be advocated as a solution *per se*. They may often be unsuitable when goods are being made for an export market that requires a large volume of items of consistent quality within a short time-frame. In these situations, it may be necessary to import modern technologies in order to reduce costs and to achieve international standards of quality. As far as standardized labour-intensive production is concerned, the necessary technology is sometimes provided or suggested by foreign investors, which often supply technical assistance in quality control and in training personnel. This may be one of the reasons why modern small industries in developing countries are sometimes as capital intensive as larger manufacturers. By contrast, more labour-intensive technologies continue to prevail in handicrafts sectors where specific skills are not as easy to substitute for machines.

C. Placing products on foreign markets

56. The search for foreign markets for small-enterprise production is a complex task requiring a systematic and professional approach to export marketing. The issue is somewhat different in the case of standardized manufactured products and in the case of more "personalized" handicrafts items. Most manufactured products have established markets and a new producer has, in a sense, merely to produce these goods in the required quality and price according to the importer's specifications. It is also true that trade-creating initiatives often come from developed country partners or their agents seeking low-cost suppliers.

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[29] Summarized in ILO, *Technologies Which Are Appropriate for Meeting Social Objectives of Developing Countries*, Geneva, 1985.

[30] However, not all traditional technologies can be upgraded and, as a matter of fact, their use lowers the competitiveness and marketability of products.

Understanding and being able to satisfy importers' needs and requirements may be sufficient for successful exporting in such cases.

57. The situation is much more difficult for **handicrafts**, which face fierce competition in limited international markets. The basic strategy for handicraft exports must therefore start by fostering demand, i.e. **markets must be created**[11] in developed countries for a particular handicraft item. The initial stages of market creation are generally beyond the capabilities of micro- and small producers and export houses due to their lack of individual influence and difficulty in attracting the attention and collaboration of foreign partners. In these early stages, leadership and financial support might come from government agencies.

58. Small producers can hardly be expected to carry out export functions by themselves. The question that then arises is how to get the product to export markets. Three **main models of distribution channels**, including varying numbers of intermediaries (whose involvement is absolutely vital for the participation of micro-enterprises in international trade), are described below.

Table 4

Typology of distribution channels

First model: *from* - Producer	to - (Buyer's agent/representative)* (in the developing country)*		to - Foreign buyer
Second model: from - Producer	to - Intermediaries	to - Export house	to - Foreign buyer
Third model: from - Producer	to - Large domestic or foreign manufacturer, based in the developing country	to - (Export house)*	to - Foreign buyer

* Brackets indicate that this particular element of the chain may be omitted.

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[11] A "product push" marketing strategy might be preferable in the case of handicrafts. The objective would be to persuade distribution channels that handle large volumes, or are influential in the trade (e.g. mass merchandisers, large importers, influential fashion leaders, opinion makers), to carry the handicraft concerned as one of their product lines. An example that can be given is the association of the House of Pierre Cardin with the promotion of Indian hand-loomed goods on European markets. Many hitherto unknown items from India became popular, bringing about a rise in exports. It should be noted, however, that fairly large investments are required to identify trading partners and gain their cooperation, with no assurance of success. See, International Trade Centre UNCTAD/GATT, *Handicrafts and Cottage Industries: A Guide to Export Marketing for Developing Countries*, Geneva, 1991, p.28.

59. **The first model** applies generally to standardized manufactured products and small formal enterprises where direct or nearly direct contact (through a buyer's agent) may be established. Both parties prefer a mutually advantageous long-term collaborative relationship. The buyer can thus build a reliable low-cost source of supplies whereas the producer is generally incorporated in an industry network through which he can acquire production and marketing information and assistance to upgrade quality and skills and to cut costs. The goods are then sold under foreign brand names.

60. Three main types of buyers can be distinguished in business relations of this kind. First, large retailers (department stores or independent retailer buying groups), which buy finished products directly from foreign manufacturers and often maintain networks of international representatives both to seek out potential suppliers and to maintain overseas buying offices. It is estimated that about 20 per cent (more than 50 per cent for garments and textiles) of developing countries' manufactures are exported through buying offices of large retailers.[32/] Second, importers-wholesalers, which buy from foreign manufacturers for resale either to domestic retailers or to other intermediaries. A large proportion of trade in handicrafts thus passes through importers, which have usually specialized in a particular product range (basketry, carpets etc.). Third, manufacturers in the same line of products, which buy finished goods or components from foreign manufacturers. The proportion of goods imported directly by manufacturers may well exceed the amount accounted for by retailers' buying offices.

61. **The second model** is more complex and serves mainly dispersed artisans and cottage-industry workers. Clearly, these informal producers would not be in a position to organize their production single handed, nor, in general, could they gain access to markets on their own, much less export directly. For these reasons, between the large number of primary producers and the export houses there are one or more layers of intermediaries which perform a range of production and marketing functions for small producers (providing raw materials, dyes, colours and designs, and buying products for resale to exporters). In most countries these intermediaries are perceived as "rent-seekers", since they tend to extract maximum profit from each transaction, leaving the producer little incentive for development and thereby stifling the spirit of enterprise and ultimately the enterprise itself. In this context, an interesting initiative has been undertaken in Sri Lanka, with strong support from the Government, to build up an alternative intermediary in the form of the Export Production Village Company, to take care of the management, financing and marketing of rural producers' exports.[33/] A similar objective has been pursued through the organization of small producers into cooperatives (with a highly variable record of success, however), or through a government agency's involvement in the organizational part of the task.

62. In the above example, intermediaries then supply the products to export houses. These do not usually engage in production, but instead handle the export

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32/ See, M. L. Egan and A. Mody: "Buyer-seller links in export development", *World Development*, No.3/1992, p.322.

33/ For details, see International Trade Centre UNCTAD/GATT, *Export Production Villages: A Study of a Sri Lankan Scheme for Rural Export Development*, Geneva, 1992.

of a wide variety of products on the basis of export licences issued by the government. In many countries, State-sponsored agencies such as handicraft corporations perform the commercial function of an export house, in addition to carrying out a developmental role, although also with varying success.[34] The advantage of large export trading houses in general is that they have greater bargaining power vis-à-vis importers and are better able to negotiate conditions of sale with them than smaller operators.

63. **The third model** is in fact a subcontracting arrangement between a micro- or small enterprise and a larger manufacturer. The first form of subcontracting consists of the physical incorporation of small unit-generated semi-processed goods, components or subassemblies in exports by larger (domestic, foreign or multinational) manufacturers.[35] In the case of local manufacturers, specialized exporters may be used for export purposes, whereas transnational corporations and their subsidiaries export without going through intermediaries. The second frequent option for large manufacturers is to contract out the most labour-intensive operations involved in products for export to enterprises in the small-scale sector, which are often of an informal nature.[36]

D. Providing know-how for international business

64. It is generally recognized that exporting is much more difficult than selling to the domestic market in terms of the knowledge and skills required. Exporting requires expertise in export marketing in addition to the ability to produce an exportable product. There is a need for personnel with the skills, knowledge and confidence to initiate and develop the export function.

65. In this context, three types of training scheme are important for economic agents in the export business. First, small enterprises (and intermediaries) would benefit from highly practical managerial training modules covering such topics as: how to start a small business; how to arrange for the financing of a small business; how to hire personnel; how to take advantage of government incentives; and how to maintain quality control of raw materials, work stations and final products. The level of sophistication of the training would vary according to the education levels of the trainees. Second, a module on export

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[34] The Hand-loom and Handicrafts Export Organization of India may be cited. It operates showrooms and retail outlets abroad, assists in the development or procurement of designs and is committed to the success of the supplier and product. See, International Trade Centre UNCTAD/GATT, Handicrafts and Cottage Industries ...", *op.cit.*, Geneva, 1991, p.17.

[35] In India, for example, the local affiliate of Philips has been operating a "Partners in Progress" programme, with 1,600 small-scale suppliers, in total employing some 60,000 people. The units receive a wide range of assistance in finance, management, product development, training, etc. See, D. L. Wright: "A Study of the Employment Effects and Other Benefits of Collaboration between Multinational Enterprises and Small-scale Enterprises", Working Paper No.60, ILO, 1990, pp.7-8.

[36] An example is the Bata Shoe Company of Ceylon Ltd., which has a subcontracting system for some operations in the production of shoes (e.g. stitching of uppers, covering of insoles), with approximately 80 sub-contractors and 1,300 people involved. National Seminar on Small Enterprise Development Opportunities in Sri Lanka, *Background Papers*, 20-22 September 1989, p.220.

marketing designed for export houses (and intermediaries) would be useful in covering export procedures, packaging requirements, costing and pricing for exports, market selection, product improvement and sources of assistance. Third, as export-promoting and small and medium-sized enterprise-developing agencies are often responsible for designing, coordinating and supporting these programmes, it would help if the relevant capabilities of their staff were built up. Personnel from these agencies, whether they be governmental or non-governmental, should be trained in the organization (and provision) of marketing activities, and in the counselling of enterprises on exporting. Moreover, all staff coming into contact with foreign partners ought to have have at least a working knowledge of a major foreign language.

66. It is widely accepted that a good level of general education (literacy and numeracy: the three "Rs") is essential if a country aspires to have a competitive workforce in today's global economy. Governments should therefore emphasize access to general education, in particular, for the poorer segments of society, and seek to improve its quality.

IV. POLICIES TO IMPROVE ACCESS TO DEVELOPED COUNTRY MARKETS FOR LABOUR-INTENSIVE PRODUCTS FROM DEVELOPING COUNTRIES

67. The key to the success of export-led growth strategies in terms of employment creation lies only partly in the hands of domestic policy-makers and internal factors in the developing countries. Labour-intensive production in small enterprises may be stimulated through targeted policy measures, but those will only lead to the expected growth in employment if the goods find markets.

68. Concerns about employment in many developed countries have long translated themselves into a growing interest in social issues, and into various forms of protectionism against labour-intensive imports from developing countries. Developed countries' trade policy vis-à-vis developing countries has always tended to be more restrictive in the sectors where both groups of countries compete. Tariff concessions often tend to be lower, and non-tariff barriers higher, for developing countries' exports of agricultural items and for labour-intensive manufactured products for which developed countries have lost their competitive edge. In this respect, the export possibilities of the small-scale sector are often affected since their products are usually relatively labour-intensive. Two main groups of market access barriers may be identified: tariffs and non-tariff measures.

69. **Tariffs** are generally recognized to have lost much of their import-restricting power as a result of trade liberalization measures. However, there are still areas where they have an important impact on trade flows, including labour-intensive trade which affects small-scale and micro-enterprises. Even if around 50 per cent of developing countries' manufactured exports to the developed world are covered by the generalized system of preferences (GSP), of which about 50 per cent are actually granted GSP treatment,[37] labour-intensive items have generally received less favourable treatment. The elements that have

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[37] For details see, for example, UNCTAD, "Seventeenth general report on the implementation of the generalized system of preferences: Recent changes and policy issues" (TD/B/SCP/6), 1994.

discriminated against them can be identified both within most-favoured-nation (MFN) rates and within the GSP.

70. First, **labour-intensive items** have **frequently not been included in the GSP schemes** at all, or only to a limited extent (e.g. tariff quotas or ceilings). In textiles and clothing, for example, only 71 per cent of tariff lines were covered by the GSP in the 1980s, the average for all industrial sectors being 90 per cent.[*] In the United States of America, textiles and textile products have not generally fallen under the GSP at all; in the European Community tariff concessions for the same group of products have been granted only to parties to the Multi-fibre Arrangement (MFA) that have bilateral agreements with the European Community up to specific amounts under MFA quotas; and for Japan GSP ceilings have been introduced.

71. Labour-intensive handicrafts and handmade products which are produced, in particular, by the small-scale sector have also been offered preferential treatment under special provisions for handicrafts and handmade items granted by the major developed countries, both within and outside the GSP. However, the coverage of textiles has been restricted even under these schemes and the use of tariff quotas has been rather frequent.

72. Consequently, higher MFN tariffs have often been imposed on imports of non-eligible goods, either totally or after exceeding tariff ceilings. In general, **labour-intensive products have faced much higher MFN tariff rates.** In this context, the extension of the product coverage of GSP schemes (including food products), the elimination of tariff ceilings and deeper cuts in MFN rates for high-tariff items may be instrumental.

73. Moreover, despite the calls for diversification of developing countries' exports from primary commodities to semi-finished goods and manufactures, the structure of MFN tariffs in developed countries has restrained this objective. In fact, the degree of protection has increased with the advance up the production chain towards higher value-added products (tariff escalation). In principle, two ways of eliminating the bias against processed products might be envisaged: one might be to negotiate a flat tariff structure with the same tariff rate applied throughout the processing chain; while the second might be to include processed products in the GSP, with a zero or very low tariff rate.

74. **Complex rules of origin and** other **administrative procedures** that have to be complied with before a country is entitled to GSP treatment should be simplified as well.

75. In the context of the results of the Uruguay Round, concerns about the direct impact in the case of further cuts in MFN rates are being expressed by developing countries, in relation to the possible **erosion** of present **preferential margins.** The hardest hit will be the least developed countries and the African, Caribbean and Pacific (ACP) countries which, at present, export mostly duty free or under very low tariffs to the developed countries. Compensatory policies for adoption by the preference-giving countries are therefore being requested.

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[*] See, V. Cable, "Textiles and clothing in a new round of trade negotiations", *The World Bank Economic Review*, No.4/1987, p.640.

76. Protectionism has increased over the years in the developed countries in response to the export challenge posed by the developing world, bringing about frequent discretionary interventions and the use of progressively more subtle forms of **non-tariff barriers** against manufactured exports, particularly those that are labour intensive from competitive developing countries. Among the main non-tariff measures, there have been variable levies, the restrictions under the Multi-fibre Arrangement,[39] global and bilateral quotas, voluntary export restraints (VERs), restrictive licensing systems, the protectionist use of antidumping and countervailing duties, and price undertakings. Protection has been applied on an industry-specific basis, i.e. selectively in those industries that have experienced major economic problems. Its application has been justified by the industries' need of a sufficient period in which to adjust their production to the new challenges. Such protection has been viewed as a temporary measure, to be phased out as the domestic industry restructures itself.

77. The ideal would be a greater awareness of the importance of **interdependence**. An increase in the South's exports would raise incomes in the South and also ease balance-of-payments problems, both of which would also lead to an increase in the South's purchases from the North. This feedback effect would not only contribute directly to the North's employment in export industries, but also, through secondary or multiplier effects, help to increase the North's growth rate, thus creating further employment.[40]

ISSUES FOR DISCUSSION

Based on the foregoing, therefore, certain issues are open to debate, as follows:

(1) According to country experiences, what types of small and micro-enterprises have proved to be the most successful in exports? What are the main reasons for their success?

(2) Are the successful exporting enterprises also employment creating, i.e. using labour-intensive technologies, or do they mostly tend to substitute capital for labour? Is there a rationale for policies favouring higher labour intensity, despite the possible conflict with efficiency objectives?

(3) What are the competitive advantages in exports of small-scale enterprises that are capital intensive, given that they do not have the economies of scale of large enterprises ?

(4) What products, or types of products, originating from the small-scale sector are particularly competitive in the developed markets in terms of

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[39] The Final Act of the Uruguay Round stipulates a progressive abrogation of the Multi-fibre Arrangement within a 10-year period.

[40] In fact, in 1990-1991 developing countries absorbed 19.3 per cent of developed countries' exports. The most important employment creation has occurred in higher value-added industries such as specific base chemicals and plastics, non-electrical, electrical and transport equipment and professional and scientific goods, where the dependence on exports to developing countries oscillates between 30 and 80 per cent of total sectoral exports from developed countries.

their marketability and the capacity to fill existing market niches?

(5) Have trade policy reforms, many of them corresponding to structural adjustment programmes, been generally beneficial or detrimental to the small-scale sector: (a) in terms of its export performance , (b) in terms of the impact on the sector of liberalized imports from abroad?

(6) What lessons can be drawn from country experiences related to the targeted promotion of small and micro-enterprises in international trade? What measures can be suggested to improve the efficiency of government assistance to the small-scale sector's exports?

(7) What types of trade barriers have been the most restrictive vis-à-vis the small-scale sector exports to the developed markets? Bearing in mind the conclusions of the Uruguay Pound, what policies should be pursued to mitigate their impact and to facilitate the access of labour-intensive products from developing to developed countries?

Annex

SELECTED PRODUCT-RELATED ISSUES RELEVANT TO THE PROMOTION OF EXPORTS BY SMALL AND MICRO-ENTERPRISES

1. Product-related aspects are becoming increasingly important to the success of exports, particularly for small enterprises. In this context, a **low price** is no longer a sufficient prerequisite for export success in developed markets. Even for the lowest-cost products within a product segment, there are minimum product criteria, including not only a competitive price but also a corresponding quality, packaging and on-time delivery.

2. **Quality requirements** exist for every product niche - whether or not the product is high-priced. If the quality of the product does not meet defined standards (which will vary according to the price categories of products) the product will not be marketable, regardless of its price or punctual delivery.

3. Two options must therefore be simultaneously pursued in order to improve the competitiveness of small enterprises in terms of quality of output. First, given the frequent failure of producers to regulate the quality of many items, and especially handicrafts, there is an argument for the introduction of **some form of quality control** by government authorities, based on defined minimum standards. For example, for certain items, governments could seek to implement internationally recognized standards, preferably based on the quality system defined by the International Organization for Standardization (ISO). Compliance with these standards would be perceived as giving a product a guarantee of worldwide credibility. In the case of exports of food products, results of microbiological tests may be required by the customer, and compliance with the importing country's standards (for example, concerning the contents and quantities of certain substances in food) may be indispensable.

4. To ensure the implementation and administration of quality standard systems, institutions and/or the establishment of services related to quality control and standards should be built up, with public support, at an international level. An example would be that of India: the Export Inspection Council is in charge of pre-shipment inspection, wherein, for example, handloom items are inspected before they are given "India item" certificates.[41/] However, such institutions, in particular in developing countries, are often plagued by problems of inefficiency and delay, and their ability to provide assistance is limited. This is one of the reasons why buyers from developed countries often prefer to send certain products to their home countries for testing. It might, therefore, sometimes be preferable to pursue certification strategies by forming links with standards and certification institutions in developed nations, as they can often provide greater credibility.

5. Second, an alternative would be for governments to require or encourage manufacturers and exporters to **impose a degree of self-control through professional associations**. The producers themselves would seek to change the workplace culture and attitudes of personnel to quality and responsibility by inducing greater awareness of the importance of quality, as well as through the improvment of work skills. Efforts to achieve a higher level of quality could be stressed, for example, in a general campaign, both by government bodies, producers' associations and export agencies. Awards for the attainment of quality could be given. Permission to use an exclusive mark of distinction (developed with financial support from the government), when the goods passed certain tests for standards, could also help to encourage the production of higher quality items. Useful technical cooperation in quality issues can be provided by customers from developed countries as well.

6. **Packaging** frequently affects both the importer's and consumer's perception of the overall quality of goods. Moreover, "packaging is a silent salesman" and

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41/ See, V. Cable, A. Weston and L.C. Jain, *op.cit.*, p.201.

has an important information function to impart. This is true especially of handicraft items which are sold as gifts and must frequently compete with various manufactured products from developed countries presented in sophisticated promotional gift packages. The increase in costs related to more attractive and competitive packaging may be offset by sales at better prices.

7. The current packaging of goods used by developing countries still quite often falls short of the requirements on highly competitive markets in the industrialized world. This is true from both a purely technical point of view (i.e. protection provided, structural design) and from a promotional point of view (graphics, sales appeal). It is therefore important to convince all those involved - government officials, trade promotion organizations, producers and exporters - of the need for technically adequate and sales-effective export packaging.

8. Because of the cost and related technical aspects, packaging for export markets may well be beyond the capabilities of most micro-enterprises. This implies that there is room for initiatives to improve export packaging, which should originate from export houses, possibly in cooperation with the government agency responsible for the development of the small-scale sector. Where enterprises are unable to cope with packaging requirements, a common packaging assistance centre could be established, with the financial participation of the government in the initial investment stages.

9. **On-time delivery** is an equally important criterion for suppliers. Goods must be delivered within the time-frame agreed, and orders must be complete. The importance of on-time delivery stems from the need to meet customers' manufacturing production schedules, as well as, for example, fashion cycles and seasonal sales peaks. The producers should be aware of this, as well as of the fact that delays in delivery may mean losses for them too, if the customer claims damages due to non-observance of the delivery date, or future orders are jeopardized.

10. Even if the product's price, quality and delivery dates do meet international standards, this does not imply that the product will necessarily sell well in foreign markets. The reason of course may be quite simple - the product does not correspond to the tastes and preferences of customers in other countries. This may be especially true in the case of fashion articles or handicrafts where the design or cut are particularly important aspects. **Product development or adaptation** is therefore often necessary to make the product marketable in developed countries. For standardized products, which do not bear the marks of their country of origin, the designs can be provided by the importers, without the participation of local designers. By contrast, however, in the case of handicrafts, contemporary designs could be created that utilize the basic distinctive features of the traditional articles but at the same time make the product acceptable to import markets. The necessary impetus or help is frequently provided by the importing market, but it is equally important to establish a domestic capability for initiating design. Training programmes to prepare qualified domestic designers, at least for the sectors with high export potential, could help in this regard and should therefore be encouraged.

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Clarity of recommendations	☐	☐	☐	☐	☐
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STANDING COMMITTEE ON POVERTY ALLEVIATION

EFFECTS ON POVERTY ALLEVIATION OF STRUCTURAL ADJUSTMENT PROGRAMMMES, JOB CREATION POLICIES AND MEANS FOR THE PARTICIPATION OF SMALL SCALE AND MICRO-ENTERPRISES IN INTERNATIONAL TRADE

STRUCTURAL ADJUSTMENT AND POVERTY ALLEVIATION*

Study prepared by T. Killick, Consultant

* The views expressed in this study are those of the author and do not necessarily reflect those of the UNCTAD secretariat.

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ACRONYMS

EFF	Extended financial facility
ESAF	Enhanced structural adjustment facility
IFI	International financial institution
IMF	International Monetary Fund
NTB	Non-tariff barriers
SAF	Structural adjustment facility
SAP	Structural adjustment programme

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INTRODUCTION

1. The beginning of the 1980s drove home a truth that had been gradually dawning in the 1970s, that the world economy was becoming increasingly unstable. This period saw the second oil shock, an associated recession in the countries of the Organization for Economic Cooperation and Development (OECD), a prolonged slump in real commodity prices, the break-out of the "debt crisis" with all its consequences for developing-country access to world savings, exacerbated by the emergence of the United States of America as a large-scale net borrower, and the erosion through non-tariff barriers (NTBs) of past trade liberalizations.

2. The combined effects of these influences placed the balance of payments of many developing countries under great strain, imposing foreign-exchange constraints. Decisive policy responses became imperative. At the same time the perception spread, especially among OECD donor Governments and the international financial institutions (IFIs), the International Monetary Fund (IMF) and the World Bank, that many past policy interventions in developing countries were aggravating economic problems rather than easing them and that these policies ought to be modified. In response to these forces, the World Bank opened its "structural adjustment" window and the IMF later introduced (or revived, in the case of the extended financial facility) its own structural adjustment facilities (the extended financial facility (EFF), structural adjustment facility (SAF) and enhanced structural adjustment facility (ESAF)). The 1980s saw a veritable explosion in influence of these adjustment programmes (hereafter called SAPs, for structural adjustment programmes) on policies in developing countries.

3. At the same time - but less in the international limelight - a number of other developing-country Governments, chiefly in East Asia, recognized of their own volition the need to respond to the deteriorating global economic environment and introduced policies which, in some cases, departed rather markedly from the standard IFI model.[1/]

4. It was the IFI-backed programmes which captured most of the attention, however. It soon became apparent that the results of these were, at best, mixed and that the adjustment process was likely to take a good deal longer than the five to ten years that had been expected. It also became apparent that, like short-term stabilization, structural adjustment was by no means painless. There was growing concern that a disproportionate share of the burden was falling on the most vulnerable - a concern culminating in the well-known call by UNICEF for *Adjustment with a Human Face.*[2/]

5. Although the IFIs have since responded to these concerns, many observers doubt whether they have moved far enough to prevent their SAPs from impoverishing the poor. There has, at the same time, been a growing amount of empirical

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1/ See, World Bank, *The East Asian Miracle: Economic Growth and Public Policy,* New York and Oxford: Oxford University Press, 1993.

2/ See, G. A. Cornia, R. Jolly and F. Stewart, (eds) (1987): *Adjustment with a Human Face: Protecting the Vulnerable and Promoting Growth,* Oxford University Press and UNICEF; G. A. Cornia, R.Jolly and F. Stewart, (eds) (1988): *Adjustment with a Human Face: Ten Country Case Studies,* Oxford University Press and UNICEF. See also R. Jolly, "Adjustment with a Human Face: A UNICEF Record and Perspective on the 1980's", *World Development,* 19(12), December 1991.

research into the equity effects of SAPs. The chief purpose of this note is to survey the most recent evidence available and to discuss its policy implications.

6. In examining the effects of adjustment, this note concentrates on the consequences for absolute, as distinct from relative, poverty or the distribution of income (income shares) - an important distinction in countries such as Chile and Mexico, where it appears that adjustment has been associated with both widening inequalities and declining poverty.[3/] This note further concentrates on the effects of medium-to-long-term programmes of structural adjustment, as distinct from short-term stabilization measures of the type supported by IMF stand-by credits, although no sharp distinction is possible and the literature often conflates the two. The coverage, moreover, is confined to effects in developing countries.

7. While it is recognized that global economic conditions and the policies and measures of major industrial countries have a powerful influence on the outcome of the adjustment programmes, including their impact on poverty, a detailed consideration of the external environment falls outside of the remit of this note.[4/] However, this is not to underrate the role of external financing, in particular in support of protecting the poor during adjustment. But besides the possibility of further debt relief, all indicators point towards a continuation of an acute financing constraint. Consequently, the external environment is regarded as given.

8. Part I contains an interpretation of the literature surveyed (largely post-1987). Part II discusses the main policy questions which arise, and part III proposes an agenda of issues for debate by the Standing Committee on Poverty Alleviation.

I. INTERPRETING THE EVIDENCE

A. The issues are too complex and opaque to permit simple generalizations

9. Because they comprise interrelated packages of measures, often intended to promote multiple objectives, SAPs demand very good levels of understanding of how each economy works and therefore good-quality, up-to-date statistics. A long-standing concern has, in most cases, been whether the data base is good enough to permit reasonably confident judgements about the ways in which programme measures work themselves out through the economy.

10. The position is especially bad when it comes to gauging the effects of

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3/ According to ECLAC estimates, the proportion of the population living in extreme poverty in Chile fell from 17 per cent in 1987 to 14 per cent in 1990 and to 9 per cent in 1992. Tabatabai and Fouad (1993, p.44) provide figures for the total incidence of poverty rising from 17 per cent to nearly 45 per cent in 1970-1987, then declining to 40 per cent by 1990.

4/ The importance of external factors was underlined by the Intergovernmental Group of Experts on Poverty Alleviation which, in its agreed conclusions, noted that "exacerbating external factors, such as deterioration in terms of trade, external debt burden and reduction of aid flows, do negatively affect development in developing countries and therefore contribute to increasing the number of the poor" (UNCTAD, TD/B/CN.2/8, 2 March 1994). For an account of trends and orientations in providing external resources for poverty alleviation, see UNCTAD, "Mobilization of external resources for poverty alleviation", background note by the UNCTAD secretariat (UNCTAD/PA/4).

SAPs on poverty groups. That requires a good understanding of the nature of poverty in the country in question, of how poverty groups are connected to the remainder of the economy, and of how specific policy measures will affect their welfare. It is clear from the literature surveyed that data of this kind remain deplorably deficient. In fact, absence of reliable data is the single most important reason why the amount of soundly-based quantitative empirical research is still quite limited. Part of the reason, no doubt, is that poverty is an intrinsically difficult topic for government statistical services to come to grips with. In some cases, moreover, the data may remain poor because governments do not choose to give data collection in this area high priority.

11. Additional obstacles to gaining firm knowledge of the effects of SAPs on poverty include:

(a) A large number of influences bear upon the welfare of the poor and it is difficult in practice to disentangle the effects of other factors from those of the policy measures incorporated in a SAP.[5/]

(b) It is difficult to distinguish between the effects of the policies in adjustment programmes and the effects of the additional finance which is attracted in support of SAPs.

(c) There are difficulties in selecting adequate performance indicators in statistically based cross-section analyses, particularly when it comes to trends in poverty.

(d) Some programmes are more fully implemented than others and effectiveness tests should ideally adjust for the degree of implementation.

12. Above all, however, any analysis of SAP effects must take into account the *problem of the counterfactual:* do adjustment programmes result in a poverty situation better than would have obtained without them? Economies are often in crisis immediately prior to adoption of a SAP, so that failure to act could scarcely fail to deepen the poverty problem. It is incorrect to impute to adjustment adverse effects which are more appropriately attributable to the initial crisis.

13. The table attempts to illustrate the potential impact of the measures most commonly incorporated into SAPs which are most likely to impact upon the welfare of poverty groups.[6/] The effects will, however, vary from economy to

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[5/] Kakwani *et al* report an average of 40 policy conditionalities in World Bank SAPs and observe that the linkages between the various policy conditionality and the standard of living "are in some cases positive, in other cases negative, and - most commonly - ambiguous". See N. Kakwani, E. Makonnen and van der Gaag (1990). "Structural Adjustment and Living Conditions in Developing Countries", *PRE Working Paper* No 467, Washington, World Bank, 1990, p.2.

[6/] Note that, for simplification, various groups of economic dependents have been omitted from the table, although in practice the young, the elderly, the disabled and other dependent groups are liable to number among the more vulnerable groups in most societies. Other categories are also commonly employed. One is the "new poor", i.e. those who were previously above the poverty line but who become impoverished as a direct result of adjustment measures, typically as a result of lay-offs in the civil service or in public enterprises.

economy. They are also liable to vary across different groupings of the poor.

14. Import liberalization, for example, is liable to harm the urban working poor by forcing the closure of inefficient local import-substituting industries which can no longer compete, throwing them out of work. Conversely, the urban unemployed could gain through improved availability of imported supplies. The same goes for smallholders growing cash crops, who may benefit from lower prices and more dependable availability of such inputs as fertilisers, insecticides and farm equipment. Smallholders who grow food but still need to buy some of their requirements (food importers) may also gain in theory, through lower prices as a result of import competition. The welfare outcome for smallholders who market a surplus of foodstuffs (exporters) is indeterminate, with both welfare-raising and welfare-reducing influences at work. This is also liable to be the situation with the landless who rely on agricultural employment and non-farm sources of income.

15. Adjustment measures, then, are liable to affect various poverty groups differently and this makes it harder to generalise about overall nets effects. Thus, among smallholders there are liable to be differences in impact upon net food exporters and net importers. No less importantly, there are liable to be major differences in impact as between urban and rural poverty groups, with much of the brunt being borne by the urban poor. Indeed, so strong is this differentiation between rural and urban areas that adjustment has been observed to have significantly narrowed urban-rural inequalities in countries such as Cote d'Ivoire, Ghana, Morocco and United Republic of Tanzania.[7/]

16. Partly as a result of the economic crisis, partly because of other inequalities and structural factors during the 1980s, rural-to-urban migration continued, and with adjustment hitting especially hard the low-income urban groups, absolute poverty in Latin America and the Caribbean changed from being predominantly rural to a situation where a majority of the poor were urban-based (although with large differences among individual countries). While a similar trend was apparent in some African countries, poverty in Africa remained largely rural.[8/]

17. A further factor complicating the analysis concerns the special position of the poorest of the poor. They tend to be economically marginalized. In the rural economy, they come nearest to the classical concept of the subsistence farmer, growing food for family consumption and having only limited connections with the market economy. Weak integration into the market economy is similarly a characteristic of the urban very poor, scratching a living as best they can in the informal, or parallel, economy from activities of sometimes dubious legality. Being marginalized, living in a culture of poverty, these groups are generally left behind in periods of economic expansion. By the same token, they are less at risk from economic downturn and the effects of government policies.

7/ On the first three countries, see F. Bourguignon and C. Morrisson (1992), *Adjustment and Equity in Developing Countries: A New Approach*, Paris: OECD, and the backing OECD country studies; on United Republic of Tanzania, see H. J. Wagao (1992), "Adjustment Policies in Tanzania, 1981-89: The Impact on Growth, Structure and Human Welfare", in Cornia, van der Hoeven and Mkandawire, *op cit*..

8/ Stewart suggests that about 80 per cent of Africa's poor live in rural communities. F. Stewart, "The Many Faces of Adjustment", *World Development*, 19(12), December, 1991.

Table

Potential impact of selected adjustment measures on various poverty groups

Adjustment measures	URBAN POOR		RURAL POOR			
			Smallholders			
	Working poor	Unemployed	Cash crop	Food exporters	Food importers	Landless/ working poor
Devaluation	N	?	P	?	?	?
Other export promotion	-	P	P	-	-	P
Import liberalization	N	P	P	?	P	?
Government food subsidy reductions	N	N	N	P	N	N
Civil service retrenchment	N	-	-	-	-	-
Cuts in social services	N	N	N	N	N	N
Increased indirect taxes	N	N	N	N	N	N
Cost recovery measures	N	N	N	N	N	N
Public enterprise reform/ privatization	N	P	P	P	-	-
Wage freeze	N	P	-	N	-	?
Credit squeeze	N	?	-	-	-	-

Key: N = substantial and negative
P = substantial and positive
? = indeterminate
- = no substantial effect

They pay few taxes and enjoy few government services; they have no access to the formal financial system; they are not touched by wage freezes; they have no formal sector jobs to lose; their livelihoods are little affected by the economic cycle or by changing relative prices. In fact, one generalization which seems justified by the evidence is that, in relative terms, it is "the poor", as distinct from "the very poor", who are most at risk in adjustment programmes or, conversely, who stand the best chances of gaining.[9/] This is especially true of the urban poor: as may be seen from the columns of the table, the urban working poor are unique in being affected adversely by every listed policy measure.

18. A further inference that can be derived from the table is that the effects of SAPs are likely to be strongly influenced by the distribution of asset ownership. For example, the outcome in the rural economy depends on whether smallholders participate in cash crop production or mainly estate production. Ghana and Malawi, for instance, represent opposite extremes in this regard. In the forest areas of Ghana, even very poor smallholders commonly grow some cocoa (the principal cash crop) and therefore benefit from the much improved real producer prices resulting from devaluations and other adjustment measures.[10/] In Malawi, on the other hand, smallholders were long forbidden from growing cash crops which compete with the output of estates, such as tea, sugar and flue-cured tobacco.[11/] Ecuador is another country where the agrarian structure channels the benefits of adjustment measures to large landowners.[12/]

19. Another implication of the table is that it is rather rare for a specific instrument to have unambiguous consequences for poverty. Reading across the various entries reveals that most measures stand to harm some groups and benefit others. Often, measures have both income-raising and price-raising effects, giving rise to net benefits or detriments that differ across groups and, being residuals, are difficult to identify. The example of trade liberalization has already been mentioned. On the other hand, cuts in social services, increased indirect taxation and cost recovery measures have uniformly negative predicted consequences. The topic of fiscal policies is discussed further in part II.

20. Given these complexities, it is not surprising (a) that the adjustment-poverty connection has proved very difficult to research conclusively and (b) that studies have tended to find varied results. The evolution of poverty during an adjustment period clearly varies from country to country, and within a given

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9/ Thus, Morrisson's study of adjustment and poverty in Morocco concludes that, overall, adjustment had a beneficial effect on rural poverty but that most of the gains went to the poor, rather than the very poor. C. Morrisson, *Adjustment and Equity in Morocco*, Paris: OECD Development Centre, 1992.

10/ See, A. Roe and H. Schneider with G. Pyatt, (1992), *Adjustment and Equity in Ghana*, Paris: OECD Development Centre.

11/ See, U. Lele, "Structural Adjustment, Agricultural Development and the Poor: Some Lessons of the Malawian Experience", *World Development*, 18(9), September, 1990.

12/ See Bourguignon and Morrisson, 1992, *op.cit.*

country.[13/] Indeed, large amounts of within-country variation considerably reduce the value of cross-country comparisons.

21. Despite such complexities, however, it is possible to suggest a number of additional generalizations which seem reasonably well-founded on the basis of existing knowledge. The following sections examine some of the more important of these.

B. The poor often are put at risk by the provisions of SAPs

22. The living standards of the poor can be eroded by measures which raise the prices of consumer goods and services. Devaluations have this effect for imported goods. The deregulation of prices is similarly apt to raise living costs (although not uncommonly, the poor already pay market-determined prices on the parallel market, as in the case of potable water, as they do not have access to subsidies). Reductions in government subsidies for food and other items (including cost-recovery measures) obviously tend to hit the real incomes of many of the poor, while they generally secure only a modest, if any, share of the benefits of such subsidies. Increases in indirect taxes, introduced to reduce budget deficits, also tend to be passed on in higher final prices, although the extent to which this affects the poor depends critically on the items on which taxes are increased.

23. Job losses are also a threat. Reductions in civil service over-manning are often included in SAPs (although often poorly implemented). Reduced employment levels are also likely to result from measures to raise the efficiency of public enterprises, or to privatize them. They may also result from lowered levels of protection in local import-substituting industries. People who find their principal source of income destroyed as a result of such unemployment-creating measures are often styled the "new poor", although in some countries they may actually have belonged to the "old poor" because those whose jobs are most often at risk have been paid around or below the relative poverty line. In Chile, for instance, poverty increased in the early 1980s as a result of adjustment-related unemployment, with over half of those thrown out of work coming from the poorest 20 per cent of the population.[14/] No less common is the tendency for real wages to be depressed as a result of SAPs, again hitting the living standards of low-income formal sector workers. It should be noted, however, that the percentage of poor working in civil service jobs remains small in most developing countries. In Peru, for instance, only 3.5 per cent of the labour force are in the bottom three deciles of the income distribution works in the government and parastatal sectors;[15/] in Côte d'Ivoire it is only 1.6 per cent.[16/]

13/ See, for example, Bourguignon and Morrisson, 1992, *op.cit.* p.48. For similar findings see Kakwani *et al*, *op.cit.* 1990; D. Sahn and A. Sarris, "Structural Adjustment and the Welfare of Rural Smallholders: A Comparative Analysis from Sub-Saharan Africa", *World Bank Economic Review*, 5(2), May, 1991, and Stewart, 1991 *op.cit.*.

14/ See, P. Meller, *Adjustment and Equity in Chile*, Paris: OECD Development Studies Centre, 1992.

15/ See, P. Glewwe and D. de Tray, "The poor in Latin America during adjustment: a case study of Peru", *LSMS Working Paper* No.56, World Bank, Washington, D.C., 1989.

24. One drawback, from the point of view of the poor, is that SAPs are not designed around the principle of minimizing costs and maximizing benefits to the poor. Although awareness of the potentially damaging effects of SAPs has increased, as discussed further on, this awareness has so far had only limited impact on programme design.

25. Thus, while cross-country studies generally show much variation between and within countries, and specific cases can be found where programme measures have had poverty-worsening effects, there appear to be no discernible differences in trends in various poverty indicators between adjusting and non-adjusting countries.[17/] A majority of adjusting countries, however, appear to have experienced worsening conditions in the towns, less so in rural areas.[18/] According to one study of adjustment experiences in Africa, of the 24 countries studied only Mauritius appeared to have simultaneously achieved the objectives of stabilization, structural adjustment, growth and protection of vulnerable groups, while 16 of the countries failed to protect the vulnerable.[19/]

C. However, the negative effects of adjustment programmes have been commonly exaggerated

26. As shown in the table, adjustment policies by no means need be uniformly adverse to the poor. Devaluation and other export promotion measures could in certain cases help create new employment opportunities and, depending on the ownership of cash crop production, raise the incomes of smallholder farmers. These and other measures also raise the cost of capital relative to labour, thus helping in some degree to generate employment.[20/] Improving the efficiency of state and public enterprise service delivery helps those of the poor who use such services. The same logic applies to reductions in the protection of domestic manufactures.

27. The extent to which outcomes are on balance positive or negative for the poor has to do not only with adjustment but also with the larger policy framework. Informal sector enterprises, moreover, become more competitive with the formal economy as restrictions are removed and the advantages given to formal sector firms are withdrawn. In some countries, e.g. Malawi, clear cases of regressive adjustment can be found, although this appears to be due more to adverse policy and institutional frameworks and uncaring governments than to adjustments *per se*. At the opposite end of the spectrum, countries such as Indonesia and Malaysia provide examples of adjustment accompanied by continued

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16/ See, P. Glewwe and D. de Tray, "The poor during adjustment: A case study of Côte d'Ivoire", *LSMS Working Paper* No.47, World Bank, Washington, D.C., 1988.

17/ See, Kakwani *et al*, 1990, *op.cit.*

18/ See, Stewart, 1991, *op.cit.*

19/ See, A. Cornia, "Is Adjustment Conducive to Long-Term Development? The Case of Africa in the 1980s," *Innocenti Occasional Papers*, Economic Policy Series No. 21, Florence: UNICEF-ICDC, 1991.

20/ Morrisson reports this effect for Morocco. See, Morrisson, 1991, *op.cit.*

reductions in poverty indicators, although in these countries, too, factors outside the adjustment programmes help to explain these outcomes. Chile also provides a favourable, but more complicated example. On the one hand, the adjustment path in the 1980s could be seen as regressive, in that it gave favourable treatment to relatively well-to-do private holders of dollar-denominated debt while reducing welfare payments to large and rising numbers of unemployed.[21/] At the same time, however, the Chilean Government was successful in targeting social spending at the poor, reducing the short-run poverty impact of adjustment, resulting in uninterrupted improvements in such indicators as infant mortality, neonatal mortality and child malnutrition.

28. Other examples of mixed results include Ghana, where some of the poor, especially cocoa-growing smallholders, have gained; food farmers especially in the northern savannah part of the country may have been unaffected; while some of the urban poor have lost, mainly as a result of job losses, others have gained from the new economic opportunities arising from economic recovery. A study of Morocco shows a beneficial effect on rural poverty - although with the poor, as distinct from the very poor, the main beneficiaries - and a worsening for many of the urban poor, especially among those who lost their jobs or whose household head was engaged in the informal sector. In the United Republic of Tanzania, too, adjustment measures have had the effect of narrowing the urban-rural income gap, with the urban poor bearing much of the burden.

29. No simple statement to the effect that "adjustment is good for the poor" or "adjustment further impoverishes the poor" can be sustained by the evidence of the case studies drawn upon above. The complexities and the mixed nature of the results leave a lot of leeway for interpretation. The extent to which adjustment is associated in the minds of observers with a worsening in poverty may be owing to certain selection or presentational biases, motivated sometimes by an advocacy agenda as well as a concern for the welfare of the vulnerable.[22/] Similarly, the theoretic virtues of adjustment to small commodity producers in rural areas is often trumpeted by neo-liberal economists with little regard for empirical evidence, suggesting the complex forces at work in many such environments.

30. Another bias is to attribute to adjustment the deteriorations which have actually been the result of economic crises giving rise to the necessity for adjustment. For example, in reviewing trends in Latin America during the 1980s, several studies point to declines in real wages and consumption standards, and increased proportions of population living in poverty, as evidence of the social costs of adjustment. This, however, overlooks the severe reductions in absorption (consumption and investment) that became *inevitable* after the debt crisis broke in 1982-1983, given Governments' decisions to honour their countries' debt commitments and the policies set forth by creditors. The most that can be said about adjustment policies, on the basis of such evidence, is that they were unable to prevent a poverty deterioration that was inherent in the initial economic situation. In assessing adjustment effects, in short, the counterfactual situation must also be kept in mind.

21/ See, Meller, 1992, *op.cit.*

22/ Reviewing the watershed UNICEF study, for instance, Preston argued that its authors had given the lion's share of attention to a minority of negative examples and that the country studies actually provide considerably more favourable evidence than the impression conveyed by the synthesis study.

31. Much the same can be said about the situation in Africa. For this region, too, there has been a tendency in the literature to attribute declining real wages and consumption standards during the 1980s to the failings of adjustment; this likewise overlooks the counterfactual. In such cases, the severity of the debt problem and more deep-seated reasons for Africa's economic malaise have been insufficiently attributed.[23/]

32. The widespread belief that adjustment programmes incorporate, or result in, particularly deep cuts in social spending provides another example of the tendency to attribute to SAPs deteriorations which are more due to the initial economic conditions. The empirical literature shows that social spending has actually been one of the more protected categories of expenditure, although there have been serious declines in the *per capita* quantity as well as quality of provision in Africa and Latin America. This deterioration is no doubt largely attributable to the rising claims of interest payments on the public debt and to general conditions of budgetary stringency, rather than to the specific provisions of SAPs *per se*. SAPs, instead, are mainly associated with relative declines in government capital formation, in subsidy expenditures and in military spending. In short, although the evidence is far from definitive, most studies of the issue find *no obvious programme impact on the shares of health and education*, which seem to behave in similar ways in programme and non-programme countries.

33. A further reason for believing that the alleged adverse impact of adjustment measures on the poor is over-exaggerated is that these do not, for the most part, have a direct bearing on the sources of poverty in developing countries. While the sources differ from case to case, they generally include:

(a) Unequal distributions of wealth, with the poor owning little by way of income-generating assets.

(b) Inadequate access to educational and other economic and social services, leaving the poor ill-educated and with few skills.

(c) Largely as a result of (b), the assets of the poor are low in productivity, partly reflecting their unsuitability to the course of modern technologies.

(d) The poor have little market power. This feeds into weak political power, resulting in low priorities for anti-poverty measures, helping to explain (a) and (b) and tending to perpetuate the poverty problem.

(e) A concentration of the un- and under-employed in poverty households, and exceptionally large family sizes, resulting in heavy child dependency, which further tends to perpetuate poverty.

[23/] See Killick for a review of Africa's post-independence development experience and the factors underlying this. T. Killick (forthcoming), "Explaining Africa's post-independence development experiences", in E. Grilli and D. Salvatore (eds.), *Handbook of Comparative Economic Development*. Westport, CT: Greenwood Publishing. An earlier version was published as Working Paper No. 60 (1992), Overseas Development Institute.

34. Non-income poverty indicators have proved particularly impervious to the influence of adjustment measures. Even during the 1980s, social indicators such as infant mortality, malnutrition and immunizations for Latin America continued to improve despite rising unemployment, declining real wages and shrinking real *per capita* social service provisions. Generally, there were no discernible differences in trends in such indicators between adjusting and non-adjusting countries.[24] To be sure, the relative robustness of indicators with respect to immunization programmes and food security has doubtless been influenced by the activities of aid donors which are unrelated to adjustment. With regard to malnutrition, moreover, even the poor have possibilities for protecting nutrition standards by switching from favoured to less-favoured foods with similar nutritional content, although the greater the poverty the less the possibilities of such substitution.[25]

35. Adjustment measures have probably impacted most on the underlying causes of poverty through their effect on employment, which has generally been negative in the short run. Over-emphasis on such short-term effects may further have contributed to an excessively negative view of the poverty consequences of adjustment. Depending on the nature and magnitude of the initial economic crisis, even the best intentioned governments have found it difficult fully to protect the poor from the adverse short-run effects of measures to reduce absorption, raise international competitiveness and restructure the productive system. The hope, of course, is that strengthened longer-term economic performance will more than compensate for the short-run costs.

36. Chile appears to provide a positive example of this effect. Being one of the first countries to initiate serious structural adjustment policies, overall poverty increased initially. However, the hoped-for economic recovery eventually materialized (aided by renewed inflows of international capital) and the indications are that absolute poverty is now declining rather rapidly in Chile, where the proportion living in extreme poverty apparently nearly halved during the period 1987 to 1992.[26]

D. Properly conceived, adjustment and structural change are necessary for an effective long-run attack on poverty

37. The term "structural adjustment" came during the 1980s to be closely associated with the policy prescriptions of the IFIs, coming to be seen as the implementation of a package of measures reflecting "the Washington consensus". Structural adjustment needs to be distinguished from the broader concept of structural change: a long tradition in development economics, stemming from the work of Kuznets and Chenery, stresses that structural and institutional transformation is intrinsic to long-run development; within this latter context, structural change is understood as a *permanent* requirement for national economies to adapt to changing circumstances and opportunities.

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[24] See, Kakwani *et al* (1990), *op.cit.*, and E. Zuckerman, "The Social Costs of Adjustment" in Thomas, *et al*, *op. cit.*, 1991.

[25] See, J. Behrman, "The impact of Economic Adjustment Programmes" in D. Bell and M. Reich (eds), *Health, Nutrition and Economic Crises: Approaches to Policy in the Third World*, USA: Auburn House, 1988.

[26] See footnote 3.

38. In this respect, a distinction may be made between structural change which occurs automatically through the market, as the response of economic agents to evolving demands and opportunities, and change that is induced by the manipulation of policy. Although many of the trends and shocks to which economies must respond are autonomous or external, there is, however, much scope for choice and the quality of a government's response can make all the difference between a languishing and a thriving economy. The potency of its choices are all the greater if past policies have retarded the responsiveness of the economy.

39. Structural adjustment and longer-term policies leading to structural change may thus be viewed as a means of keeping abreast of the changing patterns of world demand and competitiveness, technological change and long-run trends in price relativities, as well as to respond to exogenous shocks. With this perspective in mind, it is obvious that no nation can hope to prosper unless it can adapt. In poor countries, economic growth is indispensable if absolute poverty is to be eradicated; thus in such countries adjustment and structural change are essential to long-run poverty-alleviation. Governments which refuse to recognize the need for adjustment measures risk, in the long run, to impose heavy avoidable costs on their inhabitants, not least the poor.

40. For example, when the balance of payments is the chief symptom of structural weakness, a shortage of foreign exchange imposes adjustment: the only real choice is whether it will be controlled or spontaneous adjustment. In the latter case, i.e. in the absence of effective policies, import supplies will dry up, as international creditworthiness is eroded and the availability of foreign exchange diminishes. The economy will be forced to live with whatever volume of imports can be afforded, and "adjustment" will take the form of reduced output, income, employment and living standards. The economic history of Ghana illustrates the adverse consequences of the effective refusal of governments to recognize the need for change, particularly to reverse policies having perverse economic effects.[22]

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[22] The following is quoted from Roe and Schneider, 1992 (*op.cit.*):

"During most of the two decades prior to 1983 there were declines in production in all sectors. The food self-sufficiency ratio relative to basic consumption requirements declined from 83% in 1964-66 to 71% in 1978-80 and to only 60% in 1982. Production of cocoa, the main cash crop, plummeted from well over 500,000 tons to only about 200,000 tons. Mineral production declined by 46 percentage points between 1975 and 1982, while the index of manufacturing output declined by 50 per cent between 1975 and 1981 alone. The ratio of government revenue to current GDP fell from 16% in 1974-75 to 6% in 1982. Total recurrent and capital expenditure fell from over 27% of GDP in 1975 to 10% in 1983. The monetisation of large budgetary deficits combined with declining production and import capacity generated rapid inflation."

"Inevitably, this economic decline worsened poverty. Real per capita incomes fell steadily after 1970. By 1979, real average industrial earnings had fallen to only 30% of the 1970 figure and continued to fall until 1983. While the share of education and health in the budget remained fairly constant, it fell in absolute terms as the budget shrank relative to GDP, so that in 1975-82 alone educational expenditures per capita declined by 70%. Health suffered too, with growing morbidity and mortality. The infant mortality rate went up from around 80 per thousand in the mid-1970s to 110-120 by 1983-84. Nutritional standards declined, with food availability in 1982 30% below the level a decade earlier."

For further information, see also UNICEF, Accra *(1988)*: "Adjustment

41. An OECD multi-country study, based on models permitting the results of alternative policy stances to be compared with the results of the adjustment measures actually chosen, concluded that:

> "If non-adjustment is defined as a government's refusal to modify its budgetary, monetary or exchange policies - a refusal that compels it, once the possibilities of borrowing abroad have been exhausted, to resort to rationing, beginning with imports - then *all* adjustment policies are, according to our simulations, more efficient (less fall in economic activity) and more equitable (smaller increases in poverty) than not adjusting".

The same study also pointed out that delayed adjustment was considerably less equitable than prompt action because the greater severity and urgency of the initial economic crisis dictated more draconian measures and reduced the scope for protecting the vulnerable.[28]

42. Assuming that adjustment efforts are sustained and successful in restoring economic growth, we can expect the economy-wide benefits of adjustment to have a dominant effect on poverty after the short-term costs have been borne.[29] Indeed, one of the ways in which adjustment policies may harm the poor in the short run is as a result of their overall deflationary effects. Quite apart from its obvious effects on investment, employment opportunities and incomes, growth can benefit the poor by easing the fiscal constraint - broadening the tax base, raising revenues and making it easier for the State to borrow from the populace without crowding out the capital needs of the private sector. Increasing the flow of services to the poor ceases to be a zero-sum game, and thus becomes politically easier.

43. Trickle down effects from growth-generating adjustment, however, are not sufficient. The growth has to take forms that increase the access of the poor to productive assets, such as land and credit, and bring income-raising services such as education, extension services and infrastructure. A special effort has to be made to ensure that the very poor are not left out of general economic expansion, as happens if matters are left to market forces alone.

44. In many respects, the East Asian economies stand as exemplars of pro-poor policies of structural change with little recourse to the assistance of the IFIs, even if caution is necessary about the replicability of certain of their specific

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Policies and Programmes to protect Children and other vulnerable groups in Ghana"; in Cornia *et al, op. cit.; and* N. K. Sowa, "Ghana" in A. Adepoju (ed), *The Impact of Structural Adjustment on the Population of Africa*, London: James Currey, 1993.

[28] See, Bourguignon and Morrisson, 1992, *op.cit.* p.13.

[29] Psachoropoulos *et al*'s study of poverty in Latin America found that absolute poverty rose during recession and fell during economic recovery. A cross-country study by Revallion similarly found that differences in economic growth rates explained about half of variance in poverty incidence between countries. See, G. Psacharopoulos, *et al* (1992), "Poverty and Income Distribution in Latin America: The Story of the 1980's", Latin American and Caribbean Technical Department, Regional Studies Programme, Report No 27, Washington: World Bank, December 1992; M. Revallion (1993), "Growth, inequality and poverty", Washington: World Bank, 1993, p.15.(mimeo).

policy solutions.[30] These are the economies which, despite no less severe terms of trade and other shocks than those felt in other developing countries, were able to turn international trade and technological progress to their advantage, expand exports of manufactures and combine very high and sustained growth rates with macroeconomic stability. These were the flexible economies: adjusting continuously and of their own volition to changing circumstances, diversifying and transforming their productive structures, experimenting with different forms of policy intervention and abandoning those which did not yield the desired results. They were able to achieve these results while reducing inequalities and absolute poverty.[31]

45. Few other adjusting economies have even come close to the results achieved by these countries; falls in capital formation with which IFI SAPs have been associated have actually jeopardized future growth in many countries. The response of low-income economies to adjustment policies, in particular, has been less than robust, especially in sub-Saharan Africa. On the other hand, evidence is beginning to accumulate that middle-income developing countries that have persisted with adjustment policies are now beginning to reap benefits in terms of economic recovery: improvements in some of the previously depressed, heavily-indebted Latin American countries are examples, although these have admittedly been aided by large-scale inflows of capital which may not prove sustainable. How much improvement recovery in these countries may bring to the poor will hinge critically on the adoption of policies in their favour.

46. Whatever the long-term potential, however, the shorter-term reality is that structural adjustment puts poor people at risk. A cost-minimizing approach is needed which is consistent with a long-term strategy for the abolition of absolute poverty.

E. National Governments have the prime responsibility for protecting the poor during adjustment

47. It would be unnecessary to state such an obvious principle were it not for two factors: the heavy involvement of the IFIs in the design of SAPs; and the often-ignored frequency with which governments do not, in fact, display much concern over the welfare of the poor during adjustment. IFIs will be considered in the next section, while this section will concentrate on the positions of national Governments.

48. Structural adjustment programmes are politically sensitive because of their considerable impact on the distribution of income. While the focus of this paper is on the ways in which they impact upon poverty groups, such programmes are liable to have no less impact on the incomes of some of the richest and most

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[30] The following paragraphs borrow heavily from the account provided by the World Bank, 1993, *op.cit.*, and by A. Chowdhury and I. Islam, *The Newly Industrializing Economies of East Asia*, London: Routledge, 1993.

[31] Percentages of population living below the poverty line:

Singapore	1972-82	first year:	31	last year:	10
Malaysia	1973-87		37		14
Thailand	1962-86		59		26
Indonesia	1972-82		58		17

Source: World Bank, 1993, *op.cit.*, table 1.1.

powerful in the land. The existing policies which need reform are not accidental, nor are they the outcome of purely technocratic considerations. They also reflect the distribution of power and influence. For example, the common bias towards urban dwellers - and the difficulty, therefore, of shifting relative prices in favour of agriculture - reflects the greater power and potential for creating trouble of those living in the towns.

49. Policies based on the existing distribution of power therefore often have large inertial force. They cannot easily be changed because those who benefit are influential enough to block reform. Among those potential beneficiaries are the employees of the State - the very ones who must execute policy reforms. Unless treated with care, they can be a potent obstacle to change. As the experience of a number of countries suggests, political opposition can significantly retard progress in the implementation of adjustment programmes.

50. In brief, adjustment is as much a problem of political management as it is of economic design, requiring all the skills and resourcefulness of a country's political leadership. A coalition for reform has to be assembled and nurtured. Precisely how policies are reformed, and the speed and sequencing of the changes, may involve delicate political calculations. Compromises must frequently be struck. There is, as Bourguignon and Morrisson[17] point out, a considerable risk that in this process the interests of the poor will take second place, even when government is sympathetic. There is a frequent tension between the distribution of political power and a desire to protect the poor, who are usually unorganized and rarely powerful.

51. Moreover, by no means are all Governments sympathetic. Addison, for example, suggests in the context of Africa that,

> "... many of the policies that benefit the poor work against the interests of higher-income groups who are politically influential ("vocal") in their demands. These are often the very people who constitute the political power base of the region's governments. Thus governments often direct public expenditures to the benefit of high-income groups, both as government employees and as users of services, rather than to services that are important to poor people such as preventative health care and primary education. ...
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> "As a result, many governments are reluctant to define a poverty agenda ... in order to avoid sacrificing political patronage. Instead they use rhetoric such as "everyone is poor" to avoid making a political commitment to poverty reduction that would be unpopular with those who keep them in power."[18]

52. At the same time, the incorporation of pro-poor measures in SAPs can actually mobilize political support for the programme, raising its legitimacy and public tolerance of short-term hardships. Bolivia is cited as demonstrating how popular measures to protect the poor can contribute to the sustainability

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[17] Bourguignon and Morrisson, *op.cit.* 1992, p.87.

[18] See, T. Addison, "A Review of the World Bank's Efforts to Assist African Governments in Reducing Poverty", *ESP Discussion Paper* No 10, Washington: World Bank, September, 1993, pages 1 and 2.

of adjustment programmes, with grass-roots organizations participating in a special social fund set up by the State.[34/] However, given its extent, it is important to acknowledge the problem of government indifference and the limitations on what the IFIs can do to design SAPs that will protect the poor in the face of apathy, if not hostility, on the part of the government.

53. There is a further reason for drawing attention to the primary responsibility of the government. This relates to the evidence that the social costs of adjustment are a steeply rising function of delays in embarking upon adjustment measures. This was one of the strongest results of the OECD study, which concludes that:

> ... the only way to avoid the costs of adjustment in crisis is to adjust before a crisis. As the disequilibria are less severe at that time, a smaller reduction in demand is necessary. Consequently, one avoids the sharp rises in unemployment, a swelling of the informal sector and large budget cuts. The greatest advantage of this policy is that it ensures a continuing flow of foreign capital before and during the adjustment period, instead of the complete cessation that occurs when adjustment is postponed until the crisis. This capital flow prevents a fall in private investment and public expenditure, which has socially unfavourable consequences.[35/]

54. The study cites Ghana as a prime example of the heavy costs of delayed adjustment; and Malaysia and Indonesia are among their cases illustrating the benefits of early adjustment.[36/]

55. It must, thus, be a matter for governments to recognize the need for early action. Although they may help at earlier stages, the IFIs only really come into their own when an economic crisis has struck, for it is then that the country's needs for external finance give them maximum policy leverage. Prior to crises, governments may act but, perhaps more often, they may opt instead to wait.

F. Nevertheless, the IFIs must also share the responsibility in many cases

56. This note began by noting the "veritable explosion" of SAPs in developing countries during the 1980s. This, in combination with the extensive policy conditionality attached by the IMF and World Bank to their adjustment credits, places upon them a responsibility for ensuring that in these programmes the poor are not subjected to needless deprivation and that they share reasonably in any benefits generated. While this must always be principally the responsibility of national governments, the fact that the IFIs consciously seek "a seat at the policy table" and use their financial leverage to influence the policies of governments sometimes in no position to decline their stipulations means that they too have obligations. To be fair, these are obligations which both the IMF

34/ Zuckerman, 1991, *op.cit.*

35/ Bourguignon and Morrisson, 1992, *op.cit.* pp.13-14.

36/ See, D. Demery and L. Demery, *Adjustment and Equity in Malaysia*, Paris: OECD Development Centre (1992); and E. Thorbecke, *Adjustment and Equity in Indonesia*, Paris: OECD Development Centre, 1992.

and the World Bank now acknowledge.[37] IMF missions now commonly discuss distributional aspects with governments when preparing programmes and there is a requirement that the Policy Framework Papers prepared in connection with SAF/ESAF programmes should "identify measures that can help cushion the possible adverse effects of certain policies on vulnerable groups... in ways consistent with the programme's macroeconomic framework".[38] An increasing number of programmes now contain safety-net provisions, although the chief examples so far have been in the former centrally-planned economies of Eastern Europe.

57. As regards the World Bank, when structural adjustment lending was introduced it was seen as an alternative to the thrust on poverty reduction which marked its policies for most of the 1970s. Noss (1991) has stated in a World Bank *Working Paper* that its early SAPs emphasized relatively short-term macroeconomic policy measures and did not regard them as appropriate instruments for promoting social development; the 1990 *World Development Report*[39] admitted that "when structural adjustment issues came to the fore little attention was paid to the effects on the poor". Like the IMF, the World Bank has also in recent years moved to soften its stance, including the introduction of a special programme of activities known as "Social Dimensions of Adjustment" in 1987 and the creation in 1993 of a vice-presidency with responsibilities in the area of human development and poverty reduction.

58. Two recent events illustrate the changed attitudes of the IFIs. First is the provision in the recently-agreed expansion of the ESAF that programmes should pay greater attention to social safety nets, including contingency provisions.[40] The second development was the announcement by the Managing Director of the Fund, in connection with the devaluation of the CFA franc, that the IMF would agree to budgetary subsidies on some basic foods (or even petrol) as a way of protecting the poor from the price-raising effects of the devaluation.[41]

59. There nevertheless remains room for doubt about the extent to which the changes in message from the top of these agencies has affected actual operations in the field. Scepticism has been expressed about the extent to which sympathetic statements of general intent have influenced detailed programme design.[42] Against such scepticism, the World Bank has reported[43] that the share of adjustment loans that include social-sector conditionality has increased from

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[37] For an account of the factors contributing to the evolution of IMF and World Bank policies in this area, see Jolly, 1991, *op.cit.*

[38] IMF *Annual Report, 1991* pp.51-52.

[39] World Bank, *World Development Report, 1990,* Washington, D.C., p.103.

[40] Reported in *IMF Survey*, 10 January 1994, p.4.

[41] As reported in the *Financial Times*, London, 13 January 1994, p.4.

[42] See, F. Stewart, 1991 (*op.cit.*); and F. Stewart, "Protecting the Poor During Adjustment in Latin America and the Caribbean in the 1980s: How adequate was the World Bank Response?", Centro Studi Luca d'Agliano, *Development Studies Working Paper*, No 44, 1992.

[43] See, World Bank, Implementing the World Bank's Strategy to Reduce Poverty, Washington, D.C., 1993, p.20.

under 5 per cent of all SAPs in 1984 to 1986, to almost 30 per cent in 1990 to 1992. Addison[44] also reports that poverty-related provisions are now more frequently included in programmes, sometimes as preconditions for release of loan tranches. There is no comparable information about the IMF. All in all, it appears that neither institution is yet systematically adopting a cost-minimizing approach to programme design and that there remains considerable scope for improvements from the poverty point of view.

II. THE POLICY MIX

A. The need for better information

60. The importance of building a better database is central in the present context. Given all the attention to the poverty problem over the past two decades and the intense interest in the poverty effects of SAPs over the last decade, it is astonishing how little reliable information is available. Much remains to be known about interactions between poverty and adjustment; the limited volume of good country-level research available for this survey reflects the unsatisfactory data situation.

61. Bourguignon and Morrisson make specific suggestions about data priorities:

* Implementation of successive five-yearly household consumption surveys, augmented by annual surveys of a smaller household sample.

* Annual censuses of formal sector enterprises [augmented, we would add, by sample surveys of informal sector enterprises].

* Improvements in the regularity and quality of standard social-indicator statistics, on literacy and education, morbidity and mortality, access to economic, infrastructural and social services, and nutritional status.[45]

62. In addition, the Intergovernmental Group of Experts on Poverty Alleviation agreed that "the development of gender-sensitive indicators, standards and evaluation procedures is important when planning, implementing and monitoring anti-poverty programmes".[46]

63. All this, of course, has to be undertaken in conjunction with a full range of standard economic statistics, in order for researchers to be able to trace the connections between the performance of the national economy, specific policy variables and trends in poverty. The OECD project made a brave beginning but was seriously hamstrung by inadequate data. This is one of the areas where national governments have prime responsibility, but donors can help with resources, as the World Bank is doing in its Social Dimensions of Adjustment project.

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[44] See, T. Addison (1993), *op.cit.*

[45] See, Bourguignon and Morrisson, 1992, *op.cit.*, pp.87-90.

[46] See, the agreed conclusions contained in the report of the Intergovernmental Group of Experts on Poverty Alleviation (UNCTAD, TD/B/CN.2/8).

B. Principles of policy

64. Assuming now that the problem is sufficiently well understood for effective action to be possible, a number of principles of policy can be suggested.

Principle 1: MODIFICATIONS TO ADJUSTMENT PROGRAMMES NEED TO BE PUT INTO THE CONTEXT OF A COMPREHENSIVE COUNTRY-LEVEL ANTI-POVERTY STRATEGY

65. The argument was made earlier that adjustment programmes are only one of many influences on the incidence of poverty, and that the persistence of the poverty problem has its roots in economic and social structures. This not only means that actions to improve the social content of SAPs can make only a very partial contribution to poverty alleviation but also that such actions could be palliative in effect, diverting attention away from the desirability of more fundamental reforms. This point is powerfully reinforced by the conclusion of a recent ILO Working Group report setting out a framework of action against poverty:

> "... action against poverty has been greatly weakened by its fragmented and partial nature. How can wage policy be divorced from employment policy? What sense does it make to treat social security as if it had no relationship to macro-economic policy or the informalization of economic relationships? Each action against poverty faces diminishing returns on its own - but there are substantial complementarities and mutual reinforcements which are possible if an integrated approach is adopted. ..."[47]

66. Although the specifics vary from country to country, a comprehensive anti-poverty strategy is likely to comprehend *sectoral priorities* which favour the poor, e.g. smallholder agriculture and the informal sector; *the structure of asset ownership*, e.g. of land; *factoral priorities* which favour labour-intensity and employment-creation; *improved access* of poverty groups to social and economic services, infrastructure and, above all, education; *fertility restraint*, because of the connections between poverty and family size, and between population growth and unemployment; and *special programmes* in favour of the poorest of the poor wherever they are found, including the landless and female-headed households.[48] While the provisions of SAPs typically impinge upon a number of these dimensions, they certainly do not fully comprehend the relevant range of policies. In this regard, the approach of the World Bank to set its own efforts within country-based Poverty Reduction Strategies is highly

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[47] International Labour Office, "The framework of ILO action against poverty", Geneva, November, 1993, p.53.

[48] Objections may be raised that this paper has been silent on the ways in which SAPs affect the position of women. In fact, a special search was undertaken for materials on this topic but no substantial empirical literature was uncovered. If it is true that the incidence of poverty among female-headed households is greatest in rural areas, whereas poverty in the towns is related more to the low-incomes of male household heads, and if we were correct earlier in suggesting that SAPs tend to shift relative incomes in favour of the rural economy, it seems to follow that such programmes may rather improve initially the relative position of female-headed households below the poverty line.

commendable, if rigorously implemented.[49] Unfortunately, the relationship between these strategy documents and the designs of SAPs remains unclear and apparently weak.[50]

67. In short, the cause of poverty reduction is not best served by excessive concentration on improving the design of SAPs. More positively, measures undertaken to achieve such improvements are likely to be more effective when they are part of a comprehensive strategy that seeks to adapt continuously to changing economic conditions, on the one hand, and to bring about long-term structural change, on the other.

Principle 2: A BALANCE HAS TO BE STRUCK BETWEEN THE NEEDS FOR ECONOMIC ADAPTATION AND THE DESIRE TO PROTECT THE POOR

68. This follows from the argument made earlier that, properly understood, adjustment is a necessary condition for an effective long-run attack on poverty. Adjustment, it was suggested, should be understood as flowing from the necessity for any economy to adapt continually to changing economic conditions and shocks.

69. It is widely acknowledged that a proper balance between sound macroeconomic structures and policies is a necessary prerequisite to the success of poverty alleviation programmes.[51]

70. There are a number of trade-offs between adjustment and protection of the poor, at least in the short term. At a general level, concentration on the latter task, for example, may deflect attention away from the tasks of economic adaptation. It is probably true that one of the reasons why the IFIs have moved only slowly in the direction of accepting the desirability of modifying their SAPs to safeguard the interests of the poor has been the fear that governments would seek to use this as a loophole, as an excuse for weaker adjustment policies.

71. More specifically, a necessity to choose arises in the context of attempts to strengthen the macroeconomy by reducing budget deficits. One of the most fully documented consequences of IFI programmes is that these are associated with reductions in public investment and that, when faced with the necessity to cut expenditures, governments commonly cut back on capital formation in preference to current expenditures. Except as a very temporary expedient, cutting infrastructural and other forms of public investment is damaging to the requirements of adjustment, which require more investment rather than less, so as to achieve the necessary economic restructuring. Cutting back on public investment also discourages capital formation by the private sector: there is a good deal of evidence that, at the micro and sectoral levels, the former stimulates ("crowds-in") the latter. (It also creates employment in the construction sector, many of whose recruits are poor.)

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[49] See Addison, 1993, *op.cit.*, pp.19-20. This refers only to the African region and it is not clear whether a similar approach has been adopted for other regions.

[50] See, World Bank, 1993, *op.cit.* p.7, where no clear relationship is described between these two activities.

[51] See, for example, the agreed conclusions in the report of the Intergovernmental Group of Experts on Poverty Alleviation (UNCTAD, TD/B/CN.2/8).

72. However, if public investment expenditures are to be protected in the face of a necessity to cut overall public expenditures, it may often be difficult to avoid deeper cuts in educational, health and other social spending, and/or larger-scale retrenchments in public sector employment. In principle, the trade-off may be evaded by means of improved targeting of social services, or by spending priorities which protect *both* investment and poverty-related spending. Questions relating to the implementation of targeting are taken up below.

73. This dilemma can only be resolved in a specific context. As a general principle, however, overriding priority should be given to safeguarding investment, on the grounds that it is important that economic adaptation should not be impeded, because success in this task may ultimately determine a country's ability to overcome absolute poverty.

74. A trade-off may also arise when the number of public sector workers is excessive. Retrenchment will be desirable for efficiency and macroeconomic management but may throw substantial numbers of employees out of work. It is argued later, however, that the preferable course in such situations is to proceed with the retrenchment, not the least because over-inflated public administrations are detrimental to the low-cost delivery of social and other services benefitting the poor. However, in this case, it will be important to make special provision for those who become unemployed, through retraining schemes and other safety-net provisions.

Principle 3: ADJUSTMENT POLICIES SHOULD BE DESIGNED SO AS TO MINIMIZE THE COSTS AND MAXIMIZE THE BENEFITS TO THE POOR

75. The principle of cost minimization is particularly important when it comes to selection of fiscal actions, to be taken up shortly - particularly in the choice of tax measures and in the prioritization of expenditures when it is necessary to cut total non-interest expenditures. Since they take an active interest in these matters, this particularly relates to the policy priorities of the IFIs. It appears that the World Bank now takes a stronger line in defining social priorities in government expenditure programmes and is increasingly making the maintenance of services for the poor the subject of programme conditionality, although we have already noted that these efforts seem not to be closely related to the country poverty strategies which the Bank is also promoting in a number of countries.[52]

76. As suggested earlier, the IMF's position, while an improvement on its earlier stance, remains weak, even though it now takes a more detailed interest in the "quality" of fiscal adjustments, as against its former quantitative emphasis upon reducing the size of the deficit without asking many questions about how that result was to be achieved.[53] From a wider viewpoint, however, the IMF has never been willing to adopt a cost-minimizing approach to the design of its programmes, in the sense of accepting some minimum rate of economic growth, or of social provision, as a constraint upon the design of its programmes. Since government indifference could be an important part of the problem - and since IFIs play a critical role in policy and programme design -

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[52] See Addison, *op.cit.*, 1993, for a balanced and well-informed assessment of the World Bank's current efforts to reduce poverty in Africa.

[53] See, T. Killick, "Continuity and change in IMF programme design, 1982-92", *ODI Working Paper, No.69*, London: Overseas Development Institute, November 1992, pp.19-20.

both the IMF and the World Bank should place more emphasis on the desirability of adopting adjustment programmes which are consistent with properly worked out anti-poverty strategies.

77. At the same time, improvements are not mainly a matter for the IFIs. The case has earlier been argued for treating the design of adjustment as a primary *and continuous* responsibility of governments. Moreover, East Asian and other examples suggest the superiority of results, from the poverty as well as economy-wide viewpoints, of "home-grown" programmes which reflect national priorities rather than IFI policy stipulations.

78. Promoting domestic "ownership" of adjustment and anti-poverty programmes would also give support to "the involvement of the recipients at the design stage. Their participation in the implementation stage and providing them with training are equally important for the success and sustainability of anti-poverty programmes".[54/]

Principle 4: DEFENDING THE INTERESTS OF THE POOR NECESSITATES EXTENSIVE INTERVENTIONS BY THE STATE

79. It is now all too often ignored that one of the most serious of all market failures is that an untrammelled market economy tends to give rise to socially unacceptable levels of inequality and poverty. It is extremely difficult to imagine an effective anti-poverty strategy in developing-country conditions which does not necessitate extensive interventions: in the provision of safety nets, of education, extension advice and training, infrastructure and (probably) credit; in reducing inequalities in the ownership of productive assets, e.g. through land reforms; and in ensuring through trade and taxation policies that capital is not subsidized relative to labour. It is no less difficult to see how adjustment processes can be modified to minimize the costs and maximize the advantages to the poor except through the modalities of the State. Various examples of these modalities are given in the next section.

C. Implementation

1. Country specificity

80. Effective anti-poverty measures need to be related to the specific circumstances of each country. The importance of tailoring measures to country conditions is inherent in the evidence offered earlier that the poverty effects of adjustment measures are sensitive to specific economic and social structures, as well as to the nature and severity of the initial condition. Unfortunately, this factor makes it difficult to go beyond general principles into specific recommendations in a general survey of this type.

81. The possibilities of offering useful specific recommendations are further reduced by the view presented earlier of the political nature of the adjustment task, and the desirability of flexibility and compromise in its management. When it comes to the specific measures to be undertaken, the optimal sequencing of these and the best ways of implementing the principles just set out, there is no alternative to a country-by-country approach.

[54/] Agreed conclusions of the Intergovernmental Group of Experts on Poverty Alleviation (UNCTAD, TD/B/CN.2/8).

2. Integrating SAPs with anti-poverty strategies

82. How SAPs should best be integrated with a country's anti-poverty strategy will depend much upon the institutional specificities of the country in question. The essential point, however, is that the existence of a well worked out anti-poverty strategy will provide the informational base and guiding principles to facilitate the incorporation of positive poverty-alleviation components into a SAP. Having a clear statement of the thrust which anti-poverty measures should have over the longer term, presumably based on a thorough database concerning the nature of poverty in the country in question and how the poor interrelate with the remainder of the economy, should greatly ease the task of designing adjustment programmes intended to minimize the costs and maximize the benefits to the poor.

83. However, for any strategy to remain relevant, it needs to be up-dated from time to time; in this task it is important that the need for adjustment be fed back into the anti-poverty strategy, both as constraining what can be done on the poverty front and as influencing the design and sequencing of anti-poverty actions. In short, there should be a two-way relationship, with the strategy guiding SAP design and with adjustment needs feeding back into periodic modification of the strategy.

3. Positive measures are better than ameliorative responses

84. The task is to design programmes that benefit poor population groups. It is, for example, important to give priority to maintaining infrastructural and other forms of public investment, but particularly those from which poor people can benefit, such as rural feeder roads, health clinics, primary schools and the provision of treated water. Indonesia provides an example here, where investments in rural infrastructure were consciously used to compensate for income losses arising from other adjustment measures.[55/] In addition, infrastructural investments generate employment in the construction sector, which typically employs a large proportion of low-skilled workers.

85. As indicated earlier, export promotion measures, including use of the exchange rate, could contribute to the overall task of adjustment in ways which generate new employment and which, in many cases, raise the incomes of smallholder cash crop producers and farm workers. The reform or (in appropriate circumstances) privatization of relevant public enterprises can contribute both to the overall tasks of structural adjustment and benefit various poverty groups (see the table in part I). This type of action can be important, for example, where statutory agricultural marketing boards operate at low levels of efficiency, having the effect of taxing the farmers forced to sell to them. Addison notes that some of the potential benefit to rural producers of exchange rate, taxation and other reforms is not being passed on because of slowness in reforming systems of agricultural marketing.[56/] Improved delivery of economic and social services by the central government similarly has the virtue of contributing to adjustment and benefitting the poor.

55/ See, Thorbecke, 1992, *op.cit.*

56/ See Addisson, 1993, *op.cit.*, pp.22-24.

86. There may also be scope for facilitating the integration of the "new poor" - principally those who lose their jobs because of public sector retrenchments - with the development process. A good proportion of those made redundant are likely to be relatively well-educated and capable of running small enterprises. Provision of training, technical support and assistance with start-up capital could be beneficial both for the individuals in question and for the economy.

4. Poverty alleviation packages and social funds

87. However good the intentions, the positive effects of adjustment measures are unlikely to be sufficient safeguards in favour of some vulnerable poverty groups. For these, short-term "safety net" provisions are likely to be essential.[57] In particular, it is important for governments to recognize the special vulnerability to adjustment of the urban poor, as analyzed earlier.

88. One line of approach is the creation of special multi-sectoral "poverty alleviation" packages, along the lines first introduced in Ghana's PAMSCAD (Programme for the Alleviation of the Social Costs of Adjustment) then subsequently introduced in a number of other countries. Such programmes may include projects for: the rehabilitation of schools, clinics and roads; slum upgrading; targeted food programmes; and re-training schemes. Their record has been mixed, however.[58] Their multi-dimensional nature places heavy demands on often weak public administrations; programmes have proved difficult to implement, especially in rural areas. They have not always been successful in reaching many of the poor.

89. As an alternative approach, the creation of special social funds has come into favour, based on an original prototype in Bolivia.[59] These have been used to support labour-intensive infrastructure projects, producer cooperatives and the improvement of nutrition and health services. They differ from PAMSCAD-type programmes, because they are in the form of funds which can respond to local governments, NGOs and other decentralized agencies and, being more demand-driven, should respond more rapidly and flexibly. Probably the boldest such scheme is Mexico's solidarity fund, with a reported budget for 1992 of $2.5 billion. Zambia is another country which has moved in this direction. It is too early to assess the effectiveness of such funds but they nonetheless offer a promising approach, to be monitored carefully.

5. The need for equity in fiscal measures

90. It is useful to recall that in the table (see part I), the poverty effects

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[57] For a fuller discussion on social funds and safety nets, see UNCTAD, "Exchange of experiences on poverty reduction impacts of social funds and safety nets, including mobilization of domestic and external resources for poverty alleviation", issues note by the UNCTAD secretariat (TD/B/CN.2/GE.1/2), and "Recent developments in social funds and safety nets", background note by the UNCTAD secretariat (UNCTAD/PA/2).

[58] C.f. Addison, 1993, *op.cit.*, pp.27-28, and Zuckerman, E. *op.cit.*, 1991.

[59] See, J. Wurgraft, "Social Investment Funds and Economic Restructuring in Latin America", *International Labour Review*, 131(1), 1992; see also Addison, 1993, *op cit.*

of the fiscal measures included were almost wholly negative.[90] This was true, for instance, of the effects of increased indirect taxation - an option included in the table because of the trend in received opinion about tax policy in favour of increasing indirect taxes relative to direct taxation and social security contributions.[91] While indirect taxes are not *necessarily* regressive and can be designed to fall mainly on the consumption expenditures of the relatively well-to-do, if they are also to bring in appreciable revenues it is, in developing-country conditions, difficult to avoid the regressive incidence which is the usual result. In pursuing tax reforms, Governments (and IFIs) therefore need to give very careful consideration to the trade-offs between collection efficiency and equity.

91. The introduction of user charges which more fully reflect the cost of service delivery is in a similar class of actions. In theory, it is possible to design user charges that raise efficiency without adversely affecting the poor,[92] but the reality, in the face of institutional and other constraints, often falls well short of theory. Despite all good intentions to the contrary, higher user-charges often reduce the real incomes of the poor.[93]

92. There is, for example, a strong case for cost recovery in education, because of private rates of return which exceed social returns, and the frequently regressive nature of educational subsidies.[94] However, political and administrative frailties are such that it has sometimes proved difficult to implement cost recovery in education without discouraging the poor from sending their children to the very service which offers the best chance of escape from the culture of poverty. Here again, policy-makers need to think very carefully about the likely distributional consequences of introducing school fees and whether there exists adequate machinery for avoiding deprivation of the poor.

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[90] On the question of the impacts of fiscal measures on the poor, see UNCTAD, "Mobilization of domestic resources for poverty alleviation", background note by the UNCTAD secretariat (UNCTAD/PA/3).

[91] Taking a sample of 39 adjusting countries, Cornia and Stewart found that the revenue-to-GDP ratio rose in 22 countries and fell in 17 from 1980-1987. The most significant changes were a fall in social security contributions and a rise in indirect domestic taxes. Direct taxes as a proportion of the total rose in half and fell in half. See, A. Cornia and F. Stewart, "The Fiscal System, Adjustment and the Poor", Centro Studi Luca d'Agliano, *Development Studies Working Paper*, No.29, 1990.

[92] See, Behrman, *op.cit.*, 1988.

[93] In Ghana, for example, Sowa (*op.cit.*, 1993) reports that hospital fees were introduced in 1985. By 1987 such fees constituted 13 per cent of the recurrent budget of the Ministry of Health. Introduction of fees and charges for drugs has been a disincentive to the use of health services. In some rural areas, outpatient attendance has dropped by nearly 50 per cent. On average, 48 per cent of all sick Ghanaians did not consult a health provider of any kind, according to a 1987-1988 survey.

[94] See, J. Knight, "Educational Policy Issues in a Period of Stabilization and Structural Adjustment", *Journal of Development Planning*, No.19, 1989.

6. The advantages and disadvantages of targeting

93. Many of the fiscal choices relate to governments' abilities to *target* charges, subsidies and services accurately, so as to distinguish between poverty groups and others. In the face of demands for State expenditures growing more rapidly than the revenue base, it is difficult to dispute the principle of targeting. Given a financial constraint and much evidence that general subsidies are highly inefficient ways of protecting the poor, with the bulk of subsidies enjoyed by those living above the poverty line, targeting is an appropriate response - if it can be properly implemented.[45]

94. However, there is often a trade-off between the desires to limit claims on government resources and to ensure that all the poor are among those who benefit from the subsidies. A balance, therefore, has to be struck between the objectives of helping the poor and limiting subsidy claims on the fiscal base. As recently argued by Cornia and Stewart[46], universal subsidies are best at reaching all the poor but are wasteful because many of the benefits are enjoyed by the non-poor; narrowly-targeted expenditures cut out much of this waste but generally at the cost of losing coverage of many of the poor (including, probably, a disproportionate share of the very poor).

95. However, at least among the better-endowed developing countries, the practicalities of targeting may be less daunting than is often assumed. In a recent paper based on a survey of the experiences of 30 Latin American countries, Grosh [47] concludes that concern that schemes targeted at the poor will have high administrative costs "is likely to have been greatly over-stated ... a wide variety of programmes have found targeting mechanisms that produce moderately good incidence and that cost very little when measured as a proportion of overall program costs". Targeted schemes, were found to be more progressive than general subsidies - *much* more so in the case of food subsidies and somewhat more in health and education.

96. But what of the case of the poorer developing countries? The same study by Grosh is notably and significantly cautious about the applicability of her results to conditions in sub-Saharan Africa. The danger in countries without the means to administer effectively targeted schemes is that, in the face of tight financial constraints, governments will go through the motions of creating targeted schemes without being able to deliver, leaving many poor people no better off.

97. The dangers are particularly great in the case of food subsidies, even

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[45] In Morocco, for instance, it was found that only 16 per cent of the benefits of general food subsidies were enjoyed by households in the lowest three income deciles (M rrisson, 1992, *op.cit.*).

[46] See, A. Cornia and F. Stewart, "Two errors of targeting", *Journal of International Development*, 5(5), September-October, 1993.

[47] See, M. E. Grosh, "Administrative costs and incidence in targeted programs in Latin America: towards quantifying the tradeoff", Washington, DC, World Bank, 1993, p.20.

though general subsidies may be costly and inefficient. Behrman[46] cites surveys by Pinstrup-Anderson which found that, since food expenditures form 60 to 80 per cent of low-income consumers' expenditures, increases in food prices have a large impact on the poor. While the removal of food subsidies is likely to increase producer prices for farmers, this may not benefit the rural poor as they do not commonly derive a large share of their income from the sale of food. Indeed, many of them are net food purchasers. Pinstrup-Andersen concludes that "food subsidies have increased incomes and improved nutritional status among the poor, particularly, but not exclusively among the urban poor", notwithstanding their inefficiency. This is another policy area in which great care should be exercised.

III. ISSUES FOR DISCUSSION

98. In conclusion, it may be helpful to identify an agenda of topics which could fruitfully be discussed by representative of developing-country governments and the IFIs. Issues relating to the international economy are left to one side, as falling outside the remit of this paper, although it was earlier made clear that such questions as international contingency financing arrangements and other aspects of the volume of supporting external finance are crucial to any satisfactory overall approach to the alleviation of poverty in adjustment programmes.

99. The following agenda of issues is suggested:

(a) What have proved to be the chief obstacles to the creation of an adequate database on the nature of poverty at the country level? Why has progress in developing databases apparently been so slow in many countries? What are the best ways of accelerating the process and what is the potential role of external technical assistance?

(b) To what extent have poverty reduction strategies been prepared, or are planned? At the country level and within the World Bank, what are seen as the chief difficulties in relating SAP design to country poverty strategies, where these exist? What might be the recommended approach to this issue? Is there a case for creating a new supplementary IFI-based facility for providing additional finance restricted to the support of SAPs which have been explicitly integrated with a publicly stated anti-poverty strategy?

(c) In light of the past association of SAPs with reduced public investment levels, do the IFIs agree with the importance of sustaining this and, if so, what steps have they (particularly the IMF) taken to ensure that this distortion will not continue?

(d) A similar question may be asked about levels of social service provision. Are the IFIs willing to use governments' commitments to maintaining these as a criterion for deciding the desirability of a SAP credit, so as to exclude the worst offenders? How do governments react to this suggestion? More generally, would there be agreement that the IFIs should rule out the possibility of SAP credits in extreme cases of government indifference until government anti-policy policies are strengthened?

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[46] See, Behrman, *op.cit.*, 1988.

(e) What further practical steps would governments and IFIs need to take in order to incorporate into their SAPs the principle of minimizing the incidence of adjustment costs on the poor? What are their attitudes to the relative merits of poverty-alleviation programmes and social funds?

(f) Do country experiences confirm that increased reliance on indirect taxation and the introduction of cost-recovery measures usually has a poverty-increasing effect? If so, how might fiscal requirements best be reconciled with poverty alleviation?

(g) A similar question may be asked about the targeting of government services and subsidies. Does experience confirm that there is a trade-off between limiting claims on revenues and reaching most of the poor? If so, how might this tension be reconciled? Are the favourable findings concerning the feasibility of successful targeting in Latin American countries likely to be replicable in less developed countries?

(h) In connection with the devaluation of the CFA franc, does the recent IMF decision to introduce government subsidies on certain necessities in order to soften the social impact of the devaluation signal a wider relaxation by the IMF on this issue?

(i) What plans have been made by the IFIs for implementation of the stronger emphasis on social measures in the recent agreement to renew and enlarge ESAF?

(j) How can UNCTAD best contribute to the strengthening of poverty alleviation provisions in SAPs?

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EFFECTS ON POVERTY ALLEVIATION OF STRUCTURAL ADJUSTMENT PROGRAMMES, JOB CREATION POLICIES AND MEANS FOR THE PARTICIPATION OF SMALL-SCALE AND MICRO-ENTERPRISES IN INTERNATIONAL TRADE

The effects on poverty alleviation of structural adjustment programmes

Background note by the UNCTAD secretariat

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Introduction

1. The purpose of this note is to try to understand why the process of adjustment has failed to conciliate the objectives of adjustment with the needs of the most vulnerable socioeconomic groups in the countries undergoing adjustment. Although the multilateral financial institutions have acknowledged, beginning in the second half of the 1980s, the importance of protecting or compensating the poor for the adverse effects of adjustment measures, the poor none the less continue to bear the brunt of hardships arising from macroeconomic and structural adjustment. Ten years into the adjustment process, structural adjustment policies as applied so far have, generally, had little noticeable effect on economic growth, despite their high social costs.

2. The goal of adjustment programmes is to change the economic policies of adjusting countries so as to improve their economic performance and lay the groundwork for sustainable development. A two-stage approach to attain that goal has been followed:

- Macroeconomic adjustment (also called stabilization), which aims to reduce both the balance-of-payments deficit and inflation through, for example, exchange rate management, contraction of aggregate demand, tighter monetary policies, budgetary cuts and appropriate pricing policies; and

- Structural adjustment which seeks to achieve a structural transformation of the productive system of the adjusting economy through a shift from non-tradeable sectors to tradeable sectors, the removal or relaxation of government control over the economy, the reform of trade policies and/or the tax system, privatization, etc. (Woodward, 1992).

3. A distinction between the twin objectives of macroeconomic adjustment should be noted: (i) external adjustment which is "the improvement in the balance of payments, usually measured by the reduction of the current account deficit ..." and (ii) internal adjustment which is "the improvement of the domestic economy, particularly in terms of the rate of inflation and the budget deficit." (Woodward, 1992).

4. The shortcomings of an orthodox structural adjustment package, based on a combination of the above described policies and designed by the multilateral financial institutions to address the economic difficulties of indebted developing countries, have been highlighted by many economists and specialists from international organizations, research institutions and non-governmental organizations. The shortcomings, divided into three broad categories are illustrated by figures and concrete examples.

5. The first difficulty arises from adjustment policies that are not appropriate to the economic and social reality of many of the countries in question. This is particularly true of sub-Saharan Africa, as the following observations show:

(a) The promotion of tradeables through free market policies: this policy has had mixed effects on low-income and monoculture economies, benefiting surplus producers but harming food deficit households in rural and urban areas. The problem is further compounded by collective adjustment, as happens when a large number of adjusting countries increase their exports of the same goods at the same time (e.g. coffee, cocoa), increasing the global supply of these goods which results in a reduction of their prices in the international markets (Woodward, 1992). Sub-Saharan countries, for example, which are very dependent on the production and export of non-energy commodities but have been confronted by declining prices for their commodity exports in the 1980s, have had to face even further declines in commodity prices as recently as 1990 (African commodity prices are currently at their lowest level in 30 years). Indeed, in order to offset lower world prices, they have collectively produced ever-greater quantities of export commodities which have flooded the world market and driven down commodity prices to even lower levels. This, in turn, has created a vicious circle of continued increases in output and falling prices: the region's export earnings from agricultural commodities declined from $11.25 billion in 1986 to $10.14 billion in 1989 (Cheru, 1992).

(b) Devaluation and trade liberalization policies: this combination of policies has had the effect of both clamping down on domestic investment - import constraints depriving local industry and agriculture of important inputs such as spare parts and fertilizers - and of stifling domestic production - local market products facing mounting competition from cheap foreign imports and substitutes (Cheru, 1992).

(c) Budgetary cuts following tighter fiscal policies: the costs of these policies have weighed unduly on many of the poor through removal of subsidies, in particular food subsidies, and charges for social services, in particular in the education and health sectors.

6. This combination of macroeconomic policies has been adopted by many countries with little variation, despite differences in their social structure and incidence of poverty. This policy mix has failed in virtually all cases to bring about improvements in the welfare of the population or to augment the share of the poor in the benefits of economic development (Cheru, 1992). A comparison between the two major adjusting areas of Africa and Latin America, reveals striking differences: in sub-Saharan Africa, 46.8 per cent of the people lived below the poverty line in 1985 (set at $370 annual income by the World Bank); in Latin America, the respective figure was 19.1 per cent in the same year (World Bank, 1990). According to another source, 70 per cent of Latin America's 451 million people still live in poverty, 5 out of 10 lack adequate housing, decent health care, potable water and access to education (Time International, October 1991). In Africa as a whole, there were also great disparities between social groups where the richest 20 per cent of the population, during the early 1980s, earned an income four times that of the poorest 40 per cent (Cheru, 1992).

7. The second major shortcoming found in orthodox adjustment is that it aims to correct the imbalances of national economies while ignoring the international dimension of the developing countries' economic crises and their heavy dependence on the vagaries of external forces. It is an incontrovertible fact that "these adjustments have been implemented against a background of world recession and falling commodity prices" (Woodward, 1992). It is not surprising to note that the adjustment strategies have almost invariably failed to halt economic decline.

8. The third major shortcoming of orthodox adjustment is its failure to solve the debt problem of the developing countries. Many of them are still grappling with a heavy debt burden in spite of the various debt-rescheduling schemes and the debt relief and forgiveness granted to some low-income countries under the Toronto and Trinidad terms. Debt often being the major trigger of the need for macroeconomic adjustment in the developing countries, the process of structural adjustment has become "the main channel through which debt problems affect the population of the countries concerned" (Woodward, 1992).

9. This brings us to the sensitive issue of the link between debt and welfare: many economists in various international organizations and institutions along with many political leaders of developing countries agree that reducing the pace of adjustment "through the provision of adequate external financing and debt reduction" could substantially decrease the welfare losses caused by macroeconomic adjustment.

10. What should be highlighted in the link between adjustment, debt and welfare is the burden inherent in debt servicing on the income of society as a whole, including the poor and the most vulnerable. The ratio to GNP of sub-Saharan Africa's debt burden was equivalent to 97 per cent of GNP in 1989 as compared to 46 per cent for Latin America (World Bank, 1991, cited by Cheru, 1992). For some countries, e.g. Congo, Guinea-Bissau, Mauritania, Mozambique and Somalia, the ratio was more than 200 per cent (Cheru, 1992).

11. The amount of the debt has not decreased as expected. Because of a sharp decline in terms of trade, increases in real interest rates and the drying up of private lending, sub-Saharan African debt rose to $161 billion in 1989, from $147 billion in 1988, an increase of more than 9 per cent in one year, (Cheru, 1992). Similarly, the Latin American debt, which amounted to $330 billion in 1982, had reached $420 billion in 1991, despite the efforts of countries in the region to play it down (Time International, 1991).

12. Moreover, the debt structure of sub-Saharan African countries and the heavily indebted countries is composed mainly of official bilateral (41 per cent) and multilateral (21 per cent) debt, as well as debt owed to the IMF and the World Bank, it should be recalled, cannot be rescheduled (Cheru, 1992).

13. The various shortcomings mentioned by no means imply that adjustment is unnecessary. Quite the contrary. Adjustment is not only inevitable but all countries, developing or developed, indebted or not indebted, must adjust their economies constantly in line with the international economic conjuncture and adapt to an ever-changing external environment (Woodward, 1992). However,

as long as macroeconomic and structural adjustment fails to sustain growth; as long as adjustment policies are not conducive to full capacity utilization of an economy's resources through the development of domestic investment; and as long as they do not contribute to increasing the participation and reinsertion of the poor in the productive system so that they gain a bigger share in the benefits of adjustment, it is important that these strategies in their present form be revisited. The adjustment models should be constantly monitored so as to respond to the legitimate needs of the population. They may need to be redesigned to inflict the least social costs and economic hardships possible on the poor.

14. Chapter I deals with the general impact of macroeconomic adjustment and structural adjustment on the income, standards of living and welfare of the poor. It concentrates mainly on the two most affected regions: Africa and Latin America and the Caribbean. There are frequent references to countries in the Asian region as these countries have, in general, derived more benefit from the adjustment process. A section is devoted to the evolution over the past decade of the two multilateral financial institutions. In their attitude vis-à-vis taking into account the dimensions of poverty and poverty alleviation in the formulation of macroeconomic and structural adjustment programmes.

15. Chapter II concentrates on the compensatory measures devised by adjusting countries, with the support of the multilateral financial institutions, aimed at mitigating the possible negative effect of adjustment policies on the most vulnerable social groups. Special emphasis is put on the first and most important compensatory programmes, namely: the Ghanaian PAMSCAD, and the Bolivian Social Fund. In analysing these programmes, the mesopolicies approach is taken, i.e. studying the consequences of macroeconomic policies on special target groups, in particular the poor.

I. STRUCTURAL ADJUSTMENT PROGRAMMES AND POVERTY ALLEVIATION

16. Structural adjustment has had little or no beneficial impact on the economic growth of the majority of developing countries. Except in the Asian region, which exhibited an annual growth rate of 7 per cent from 1980 to 1988, economic performance of developing countries in other regions stagnated during that period: annual growth of GDP for the African subcontinent averaged 0.8 per cent while that of Latin America and the Caribbean averaged 1.5 per cent (World Bank, 1990). In spite of an improvement in the growth performances of some individual countries in the latter two regions during adjustment, the overall growth record there remained poor, justifying the assertion that "the scarce evidence of growth appears to relate very largely to a small group of large, relatively high-income countries, with a substantial degree of industrialization, low dependence on commodity exports and low or moderate external debts. Such countries are not representative of developing countries as a whole, and are increasingly unrepresentative of countries undertaking structural adjustment programmes (with the exception of Eastern European countries)" (Woodward, 1992).

A. The impact of adjustment programmes on the welfare of the poor, in particular on incomes

17. This part of the report reviews the economic factors hindering human development during adjustment, mainly those affecting incomes of the poor - the determinant of their welfare. In general, certain measures included in the policy packages of structural adjustment programmes have imposed considerable losses on incomes and standards of living of the poor in the developing countries. These have included:

- A reduction or loss of wages and salaries;
- Rising food prices;
- A removal or reduction in subsidies, in particular food subsidies;
- A reduction in the provision by the State of social services such as health and education and loss in the quality of these services as Governments shift resources to making payment on the debt; in addition the poor have increasingly had to pay fees and charges for access to public services;
- Increases in indirect taxes; and
- Increases in interest rates on credits.

18. The attention of the reader, however, is drawn to two limitations.

(a) There is a paucity of data on poverty and income distribution. Little is known, for example, of the impact on incomes of the poor following changes in the pattern of social groups' economic activities. Statistical data have not kept up with the rapid changes and shifts in the economic fate of the various groupings, poor and non-poor alike, nor taken account of changes in the social fabric (ILO, 1990; Ghai, 1991; Woodward, 1992).

(b) The term "poor" covers a very heterogeneous group. Analysing the impact of adjustment on their economic status and devising measures to protect them is no easy task if only because of the extreme diversity of the economic categories into which they belong, in terms, for example, of location, sources of income, ownership of assets, health and nutritional situation, educational background, household composition, etc. (Killick, 1990; Woodward, 1992).

19. It is believed that adjustment as a growth-generating engine should bring about an improvement in the incomes of the poor and maximize their welfare over the long term (Woodward, 1992). Unfortunately, so far, macroeconomic adjustment is generally known to be associated with "an immediate and sharp decline in per capita national income" in a majority of adjusting countries in the two regions most severely affected by macroeconomic and structural reforms: Africa and Latin America. Between 1980 and 1989, real per capita incomes fell by about 30 per cent in sub-Saharan Africa and by about 15 per cent in Latin America and the Caribbean, when estimated on the basis of the haemorrhage of resources out of the regions and of the deterioration of the terms of trade (World Economic Survey, 1990). Among

adjusting countries of the African subcontinent, three-quarters had declining per capita incomes; in Latin America and the Caribbean, more than four-fifths of the countries exhibited diminishing per capita incomes (Stewart, 1991). Bolivia, Haiti, Panama, Nicaragua and Trinidad and Tobago, for example, suffered declines of 20 per cent while other countries, including Argentina, El Salvador, Guatemala, Honduras, Mexico, Peru and Venezuela, witnessed a fall of between 10 and 20 per cent (Ghai, 1991).

20. It would thus be relevant to study the main factors contributing to erosion of incomes of the poor during the adjustment process: these involve, among others, changes in (a) wages; (b) prices of basic goods, especially food; (c) employment; and (d) the availability of social services. In looking at these indicators, the wide variety of the national experiences will be taken into account, as appropriate.

(1) Wages

21. Adjustment packages often include reforms that imply reductions in real wages, in particular the real wages of urban workers. In some adjusting countries, resorting to real wage contractions has become common practice as a means to avoid redundancies when the choice lies between lower wage levels and unemployment (Ghai, 1991). Policy reform along such lines is based on the assumption that the poor in urban areas being better off than the poor in rural areas, the bulk of the poor in developing countries being principally located in rural areas, penalizing the urban poor - through wage freezes, reduction of subsidies and price increases - while favouring the rural poor, would restore the rural-urban balance in terms of economic welfare.

22. This reasoning, valid when applied to the adjusting countries of sub-Saharan Africa, where it is estimated that the rural poor account for 80 per cent or more of the total number of poor, is, however, less well-founded when applied to the Latin American countries where the poor are less rural and where, in their majority, they may have been affected by depressed real incomes (Stewart, 1991).

23. Many researchers contend that the burden of wage restraints in the adjustment package undoubtedly impinges on the poor and, considering the fact that the borderline between the poor and the non-poor in developing countries is rather narrow, had prompted the impoverishment of the non-poor as well.

24. In Latin America, real minimum wages fell by 11 per cent between 1980 and 1985 (Ghai, 1991). Evidence for 11 countries in the region shows that average real wages in 1989 were 10 per cent or more below their 1980 level while urban real minimum wages fell over 20 per cent below their 1980 level in 8 out of 11 countries (Stewart, 1991).

25. In Africa, by 1986, the minimum wage of most African countries had declined by at least 40 per cent compared to a decade earlier (ILO, Advisory Committee on Rural Development, 1990). In sub-Saharan Africa, out of 18 countries for which there are data, real wages fell in 16 during 1980 to 1986. In countries such as the United Republic of Tanzania and Nigeria, the fall was especially sharp: in the former, the real minimum wage in 1986

was 35 per cent of its value in 1980 while in the latter the average wage fell by 25 per cent during 1980 to 1985 and the minimum wage dropped by 45 per cent (Stewart, 1991).

(2) Food prices and the rural/urban equilibrium

26. The real incomes of the urban and rural landless poor have been adversely affected by changes in the prices of food during adjustment. Soaring food prices may be a consequence of various elements in the policy package, namely, rising producer prices aimed at improving the rural/urban terms of trade in favour of the agricultural sector and enhancing export crop and food production.

27. In Africa in particular, higher producer prices have been administered at the expense of the standards of living of other groups, mainly wage earners and subsequently, higher food prices not only did not improve equity but worsened the standard of living of small farmers, the landless and urban wage earners who are net purchasers of food, while benefiting mainly large farmers and producers of export crops (c.f. ILO, 1990). They most probably even increased poverty in rural areas as rural populations suffered losses in their welfare through income reduction and fluctuations in earnings. Indeed, small subsistence farmers may have been compelled to shift to the production of export crops to be able to survive, hence becoming purchasers of the food they used to produce; they may have incurred income losses from accumulated debt and contracted consumption loans; and they may have suffered losses of assets, for instance, by having to forfeit their tiny plot and resort to tenancy by offering their labour to larger landowners (Streeten, 1989). Moreover, poor rural households may have had to cope with further income loss due to dwindling remittances from impoverished urban areas.

28. Despite substantial differences in the concentration of land ownership, the implications of this policy for the poor were more or less identical in both Africa and Latin America: in Africa, the survival strategies of families having to weather adverse economic trends and to struggle in order to secure food and cash income, were to undertake economic activities in all sectors of the economy (in the traditional agrarian sector as well as in the urban formal and informal sectors) and to reinforce the existing link between rural dwellers and their family members who had migrated to the city. In Latin America, although the rural-urban income gap was less wide and a slight decline in absolute poverty in rural areas could be observed, rural poverty remained important in some countries (c.f. Brazil). Other sources contend that the proportion of people below the poverty line has remained unchanged in rural areas (54 per cent) while that in the urban areas went up from 21 to 29 per cent (Ghai, 1991). Unfortunately, not enough data and reliable statistics exist to support those rough estimates. As in Africa, the gains from higher food prices have accrued to large and medium-size farmers, to the detriment of agricultural workers and small peasants and led to a deterioration in the nutritional standards of the poor (Peru, Mexico).

29. The case of Côte d'Ivoire is interesting in this connection. The incidence of poverty in that country has been particularly high among food producers and was estimated at 42 per cent in 1980, as compared with 27 per cent among export-crop producers. During the Côte d'Ivoire

stabilization and structural adjustment programmes (1981-1987), this policy reform, despite the fact that it inflicted serious declines in per capita income on all groups, imposed the heaviest loss in per capita income on food producers (4.7 per cent per year) which constitute the poorest majority. Comparatively, the loss incurred by export-crop producers (1.3 per cent per year) was minimal (Stewart, 1991).

30. This policy change in Côte d'Ivoire was considered by the World Bank as a necessary measure to enhance agricultural production and cushion farmers while contributing to improving the rural-urban terms of trade, hence reducing income inequalities between the two sectors (Demery and Addison, 1987). However, the fact that the gains from this policy reform did not accrue to all farmers but solely to export crop farmers to the detriment of food producers which constitute the poorest majority, suggests that export-increasing policies have been at the expense of the poverty alleviation objectives.

31. Consequently, one could argue that correcting domestic imbalances in the short run (namely, the rural/urban imbalance) should not have priority over nor prejudice the long-term intra-sectoral development, especially when it is not a fundamental constraint and when the sector in question incorporates the majority of the most vulnerable, as it does in sub-Saharan Africa. Moreover, in order to minimize the negative impact of adjustment measures aiming at correcting domestic production bottlenecks, they "need to be implemented in conjunction with equitable land tenure systems and the provision of credit, input and extension services to the broad mass of the peasantry and not simply to the relatively few engaged in the production of export crops" (Cheru, 1992). A good illustration of a more equitable adjustment can be found in Malaysia where measures were taken to protect the poor against the social damage caused by the 1970 stabilization programme; they relied, among other compensatory measures, on food subsidies and exemption from credit restrictions (Addison and Demery, 1989).

(3) Employment, unemployment and the emergence of the informal sector

32. Macroeconomic reforms and structural adjustment have often provoked massive redundancies, real wage contractions in the public and urban formal sector and the emergence of an informal sector that absorbs the underemployed and the retrenched workers from all sectors. Employment growth in the formal sector slowed in most Latin American and African countries and declined in many others (Stewart, 1991). In Latin America, rising unemployment and falling real wages increased the population below the poverty line. Their numbers rose from 130 million in 1981 to 150 million in 1986 (ILO, 1990). The hardest hit have been wage-earners. Although they do not necessarily belong to the most disadvantaged groups, they may sustain serious hardship and impoverishment resulting from a lack of adequate compensatory employment policies aimed at diminishing the social costs of such measures. When unemployment is combined with a high population growth rate, as is the case in many African countries, this can lead to increasing unemployment and underemployment.

33. For Latin America as a whole, it is estimated that the conditions prevailing during the adjustment period of 1980-1985 hampered the creation of about 4 million jobs which would have been otherwise created had the

pre-crisis trends continued (Albañez, 1989, cited by Stewart, 1991). "Urban unemployment rates rose sharply in many Latin American countries in the early 1980s ... Out of 16 countries, unemployment rates were above the 1980 level in 1989 in 10 countries and the same or lower in 6" (Stewart, 1991).

34. In Africa, wage employment fell significantly in Côte d'Ivoire, Gambia, Niger, Swaziland and Zambia while in others the increase in the number of jobs was well below the growth in the labour force. Rising urban unemployment dominated the economic scene during the 1980s in such countries as Nigeria, Liberia, Côte d'Ivoire, Senegal, Kenya, Togo, Niger, Mauritius, the Seychelles, et al. (Stewart, 1991).

35. Following the sharp rise in urban unemployment in both Africa and Latin America during the first half of the 1980s, the urban informal sectors expanded considerably and rapidly (4.9 per cent per annum in Latin America and 6.7 per cent per annum in Africa), absorbing retrenched labour in low productivity activities and less technologically sophisticated indigenous enterprises and small industries. In Argentina, Brazil, Colombia, Chile, Mexico, Peru and Venezuela, employment in the urban informal sector grew annually at a rate of 5.2 per cent compared to 0.7 per cent annually in the urban formal sector (Pinstrup-Andersen, 1989, cited by Stewart, 1991). The growth of the informal sector as a shelter for unregistered low-income employment offers an alternative solution to industries facing difficulties and to lower-middle class retrenched workers of the formal sector. "The informal sector has become a kind of catch-all market, merging into a subterranean economy, through which workers are linked to many other segments of society without obligatory reference to the laws or norms which have been publicly established and legally sanctioned to regulate economic relations among parties" (Ghai, 1991).

36. This phenomenon has greatly contributed to informalizing the working class in both regions, blurring the borderlines between the lower-middle and lower working classes and between skilled and unskilled workers. It eroded the incomes of minimum-wage earners especially in Latin America, this not being the case in Africa though - in 1980, wage employment occupied less than 10 per cent of the economically active population (ILO, 1990) - because of the lower dependence of poor African families on wages and salaried employment. It also weakened the bargaining power of Latin American labour movements, undermining the solidarity between skilled workers in larger industries which at times had brought about substantial positive results.

37. Moreover, despite what has been alleged by some economists - that the outgrowth of informal sectors in developing countries are a healthy response to bureaucratic incompetence and administrative bottlenecks - the available evidence shows that economic activities in the informal sectors deprive Governments of considerable tax revenue. According to one estimate, earnings in the informal sector of Brazil, for example, amounted to $75 billion a year, equal to 20 per cent of that country's GNP. The question of how to reinsert gradually these sectors back into the formal sector is not simple.

(4) Government spending on social services

38. Another element in the policy package adversely affecting the poor in particular are budgetary cutbacks on social services such as education and health. In general, in Africa and Latin America - unlike adjusting countries in the Asian region which only moderately targeted budgetary stringency on the social sectors and were generally more inclined to invest in the development of human capital - per capita Government expenditure on health and education declined substantially. "The aggregate effect of the decline in total government expenditure per capita in the two adjusting regions, together with the decline in the share of health and education was a decline in social spending per capita of 26 per cent for Africa and 18 per cent in Latin America in 1980-1985" (Stewart, 1991). Comprehensive data for Latin America and Africa shows that 60 per cent of the countries of the former region experienced cuts in per capita expenditure on health services during 1980-1986 (Albañez, 1989 cited by Stewart, 1991) and 63 per cent in the latter as regards combined per capita expenditure on health and education (Jepersen, 1991, cited by Stewart, 1991).

39. In some adjusting countries of the two regions, the decline of expenditure on health had the negative effect of deterring low-income users of health services, foremost, because of the introduction of user charges and secondly, because of the reinforcement of the pre-adjustment trend of devoting a large share of health spending to curative care and large medical infrastructure to which the poor have little access. The poor, indeed, are more in need of preventive care and less inclined to use hospital and health clinics than the non-poor. None the less, as a result of a combination of donor contributions and national allocations, both regions witnessed an expansion of low-cost health care interventions in immunization, especially child immunization. The rate of coverage is estimated to have increased substantially in both regions - 20 to 30 per cent per year during 1981-1987 which greatly contributed to a decline in infant mortality rates even in countries which have sustained considerable economic difficulties during adjustment (Van Der Hoeven, 1991; Stewart, 1991).

40. As regards education, in general, the share of primary education in total education increased in many countries of the two regions. However, in a large number of African countries, including Zambia, Mali, Sierra Leone and Togo, the combination of general cuts in public expenditure and introduction of fees for primary education led to a considerable fall in primary school enrolment (Van Der Hoeven, 1991).

41. The country case studies of Sri Lanka and Chile, which are examined briefly below, illustrate the diversity of approaches that can be adopted towards social spending in developing countries undergoing adjustment.

The Sri Lankan case

42. Sri Lanka is often cited as an example of high social expenditure, in particular on education and health: at the beginning of the 1990s, expenditures on education and health services exceeded 15 per cent (United Nations, 1993). Policies of free education - Sri Lanka's literacy rate of over 90 per cent is the result of 45 years of free education - and

free or subsidized food provision (rice, for instance) to those most in need have contributed substantially to maintaining good general standards of education, nutrition and health. Throughout the difficult years of recession and adjustment, there has been an attempt to sustain a high level of public spending on health and education.

43. During the 1980s, following the agreement by the new Government to a structural adjustment programme, significant cuts in social expenditure led to a deterioration of the nutritional status of the poorest population and an aggravation of poverty (Sahn, 1987). The shift from the pre-1977 welfare-oriented approach to development, in which equity-oriented policies such as high spending on health and educational services and food subsidies prevailed, to a more market-oriented, outward looking economy, has increased poverty which had already been substantial during the 1970s.

44. The change in policies centred mainly on liberalizing markets and reducing welfare, in order to achieve economic growth. The share of government expenditures on subsidies and welfare programmes was reduced - spending on health, education and food subsidies declined from 38 per cent in 1977 to 22 per cent during the years 1980-1982 - to the benefit of large infrastructure development projects. Despite rapid rates of growth of GDP achieved through this shift to capital-intensive investment programmes, the results of a positive economic performance have not yet trickled down to the poor. Available data show a growing inequality in levels of consumption (Sahn, 1987). It should be noted, however, that, starting from a high level of equality in access to basic needs, Sri Lanka remains a country where social inequality is relatively slight.

45. While economic reforms were necessary to correct domestic imbalances and reduce State domination over the Sri Lankan economy, the policies introduced in order to implement those reforms weighed on the poor and resulted in tangible losses for them. Policies such as a series of currency devaluations and price decontrol, together with the ensuing inflationary pressures, were not accompanied by commensurate increases in wages and the real value of food stamp transfers eroded rapidly. This constituted a threat to the welfare of the poor whose real incomes and standards of living declined substantially (Sahn, 1987).

46. In order to cushion the negative impact of their structural adjustment programmes, the Sri Lankan authorities introduced the Janasaviya Programme in 1989, an anti-poverty programme designed to combat poverty in the rural areas (88 per cent of Sri Lanka's poor live in rural areas) through establishing public employment schemes. These employment schemes have generally been labour-intensive and self-targeted, involving wages at rates below the market level which would attract only the truly poor.

47. Public expenditure on this scheme constituted 3.5 per cent of the country's GDP by 1991 (Islam, 1991). It combined the existing food stamp scheme (the entitlement to a food coupon is conditional on a household supplying 24 days of labour every month on rural public works, such as road construction, irrigation projects, reforestation schemes, etc.) and the provision of a monthly cash payment (SLRs 2,500), to be received by each household over a period of two years. Some 58 per cent of the monthly

assistance was to be used for consumption and 42 per cent (SLRs 1,042) was to be saved for investment purposes. This meant that, at the end of the two years, the accumulated sum would be invested by families in various kinds of income-generating activities (small-scale industries and enterprises for instance) for which they would have received technical training during the two-year period. Currently, there are 7 million foodstamp holders and 165,000 families benefiting from this programme (Islam, 1991 and The Economist Intelligence Unit, Country Report, 1990).

48. What makes Sri Lanka an exceptional and interesting case in this regard is that the Sri Lankan Government has integrated poverty reduction and alleviation goals in the design of its macroeconomic policies. During critical periods where policy reforms had to emphasize economic growth - through enhanced exports and the promotion of the private sector - with a view to reducing the balance-of-payments deficit, measures targeting the poor have been implemented which aimed at helping those who benefited inadequately from economic growth.

The Chilean case

49. The Chilean Government undertook adjustment in the 1980s which spread across two main periods, the 1981-1982 period of the "automatic adjustment mechanism" pursued by the Chilean economic authorities and the 1983-1989 period of adjustment under IMF and World Bank auspices.

50. The 1981-1982 period emphasized deflationary measures through increased real domestic interest rates until early 1982, and devaluation during the rest of the year. High real interest rates and later, sharp real devaluations coupled with a sudden drying up of foreign credits, created chaos in the domestic financial system and had a dramatic effect on domestic production: imports decreased (in constant dollars) by more than 50 per cent; domestic spending fell by almost 20 per cent; output fell by 12.8 per cent. The social costs of this adjustment period were high and the sharp fall in production was followed by a large number of bankruptcies and a steep rise in unemployment which reached nearly 25 per cent of the work force. Wage indexation was eliminated in June 1982 and real wages fell by almost 20 per cent (Meller, 1991; Stewart, 1991).

51. The second adjustment period began in 1983 and Chile agreed to three multilaterally supported programmes: (i) in 1983-1984, an IMF stand-by programme through a Compensatory Financing Facility (CFF); (ii) in 1985-1987, an IMF Extended Fund Facility programme (EFF); and (iii) in 1985-1988, a World Bank structural adjustment loan (SAL). The prior objectives of the first IMF programme were that Chile should reduce its current account deficit and its massive foreign debt at a quick pace. This resulted in external debt servicing levels which approached 20 per cent of GDP and 70 to 80 per cent of exports. It also generated real cuts in public current and capital spending and a decrease in the Government's real wage bill. In spite of the fact that the current account deficit was reduced to 7.3 per cent of GDP in 1984 from the 14.7 per cent of GDP it had reached in 1981, it was far from the projected 4.5 per cent of GDP. Before the end of this adjustment phase, the unemployment rate exceeded 30 per cent and real wages were reduced by almost 20 per cent (Meller, 1991).

52. The 1985-1987 programme aimed at reducing further the current account deficit, this time through trade expansion and an orderly servicing of the debt with a view to bringing down the debt-to-GDP ratio. During this period, the current account deficit fell from $2.1 billion in 1984 to $0.8 billion in 1987 and throughout the period, the World Bank and the IMF supported the Chilean Government in the negotiation of their debt with commercial banks.

53. During 1988-1989, adjustment focused on the promotion of copper exports - which represented more than three-quarters of total exports in 1970, fell to less than half in the 1980s - as well as diversification into other export areas. The export sector increased its share of real GDP by more than five percentage points and Chilean exports increased sevenfold in 1989, from $1.1 billion in 1970 to more than $8 billion in 1989. This change implied a redistribution of income, the big part of it still being captured by the public sector, with around 36 per cent of total exports originating from State-owned copper mines (Meller, 1991).

54. By 1988, real devaluation had affected the purchasing power of the bottom four deciles of income distribution. It inflicted relatively less pain on the middle- and upper-income groups. The upper-income quintile lost 13 per cent less real purchasing power than did the lower 40 per cent income group while the middle 40 per cent income group lost only about 4 per cent less real purchasing power than the lowest 40 per cent income group. A survey on employment covering 3,747 firms and 200,000 employees revealed that during the adjustment recovery workers in small firms in all sectors and regions sustained the largest loss of purchasing power. This led to the argument that "the structural adjustment of the 1980s was implemented primarily in the labour market" (Meller, 1991) and that expenditure-reducing policies during adjustment were achieved through important cuts in unit input costs, namely, reduced labour costs, hence to the detriment of the workers (Meller, 1991).

55. Though macro-policies worsened poverty, there were meso-policies directed at protecting the poor during adjustment which helped mitigate the effects of adjustment. Incomes were sustained at minimum levels by very extensive public-works schemes (Stewart, 1991); because of the high rate of unemployment in 1982, an emergency employment programme was created providing a minimum wage, after taxes, of $100 a month. A positive impact of the fall in real wages was the expansion of output in the labour-intensive sectors characterized by a relatively high output-employment elasticity (Meller, 1991).

56. Despite reduced government expenditure on social programmes such as health, education and housing (expenditure on education and health fell during the period 1982 to 1987 by 15 per cent and 25 per cent, respectively), the Government increased spending on specific programmes in which the poor and vulnerable were targeted (nutrition, immunization, etc.), in particular pregnant mothers and children under six. The result was a continued decline in child mortality, neonatal mortality and child malnutrition. The infant mortality rate dropped from 74 per 1,000 live births in 1973 to 20 per 1,000 live births in 1987, a record decline in Latin America (Castañeda, 1992).

57. Today, the Government considers trickle-down growth with equity to be the main tool to eradicate poverty. The improved economic growth of the 1990s (10 per cent in 1992) is believed to have reduced the number of poor, from 5 million during the late 1980s to 3.5 million currently. Unemployment is below 5 per cent and the official minimum wage is $100 a month.

58 In short, the Chilean experience was characterized by well-designed meso-policies which helped protect the most vulnerable of the poor during the 1982-1983 recession. Emphasis was put on intrasectoral allocation which gave the poor sustained access to basic services.

B. The evolution of the multilateral financial institutions in their attitudes toward poverty and poverty alleviation during adjustment

59. The pre-1985 IMF/World Bank adjustment schemes sponsored structural adjustment programmes which emphasized increasing reliance on market forces and export-led economic growth but paid little attention as to how the economic burden of these adjustment programmes was being borne by the different social groups, including the poorest and most vulnerable among them. Criticism of the IMF/World Bank's overlooking of the hardship that these programmes inflicted on the poor drove the Bretton Woods institutions to shift their thinking and acknowledge the social costs that an adjustment programme may impose on social groups, including the poor. That these social groups should be protected from the potentially adverse effects of adjustment, at least in the short-term, was also recognized.

60. In 1987, the Programme of Action to Mitigate the Social Consequences of Adjustment (PAMSCAD) was initiated in Ghana by the World Bank, with donor support. This led to a series of sectoral programmes in health and education, as well as projects and programmes in agriculture and other directly productive sectors supported by the World Bank (Stewart, 1991; Jolly, 1991). Again, in 1987, the World Bank with UNDP and the African Development Bank created the programme called the Social Dimensions of Adjustment (SDA), designed to improve statistical data collection and analysis in Africa on how the poor were affected by adjustment policies.

61. Nowadays, the need to take into account social and human concerns is widely recognized and the publication of several studies and reports emphasizing those concerns is an indication of this awareness (e.g. the 1990 World Development Report, etc.). Ongoing criticism, however, has highlighted the fact that the Bretton Woods institutions have not made significant changes in the basic design of their policies in terms of the choice of policy instruments and the balance of instruments used (Stewart, 1991). According to many economists and experts from a variety of international organizations and institutions, adjustment that fully protects human needs should be incorporated into the basic design of both macro- and meso-policies. Up to the present, no attempt has been made to explore how human concerns may be incorporated in the macroanalysis. The need to protect the poor during adjustment has, on the contrary, been restricted to and translated into action at the sectoral level only (Stewart, 1991; Jolly, 1991; Van Der Hoeven, 1991; Woodward, 1992 etc.). Moreover, apart from the fact that macropolicies need to take human concerns fully into account, the

necessity of improving statistical data on poverty, and of involving representatives of interested groups, such as trade unions, community representatives, women, etc., in the discussion on adjustment policies and social changes as well as in the preparation of policy framework papers, was emphasized (Jolly, 1991; Van Der Hoeven, 1991).

62. These suggestions have, apparently, not been ignored by the Bretton Woods institutions. Attempts have been made in the design of strategies for the 1990s to overshoot the recommendations of the 1990 World Development Report which focused on labour-using growth and investment in human capital as essential elements contributing to reducing poverty. The World Bank Global Agenda for Poverty Reduction in the 1990s alluded to a direct attack to be undertaken on poverty. In a joint progress report prepared for the Development Committee in 1990, the Bank mentions that it helped Governments "to ensure that poverty aspects are fully incorporated into the design of future adjustment programmes". The Fund, in the same report, states that "many macroeconomic and structural policies improve the position of the poor groups ... A well-designed structural policy package includes social sector reform measures to enhance the nutrition, health and education of the poor ... the Fund has been paying increased attention to the implications of these policies for income distribution and poverty ... the Fund has provided advice to member countries on ways to promote poverty reduction through appropriate macroeconomic and structural policies and on measures to protect the poor and vulnerable groups during adjustment" (World Bank, IMF, 1990). The adoption of these improvements under orthodox structural adjustments remains, nevertheless, uneven.

II. COMPENSATORY MEASURES AND PROGRAMMES DURING ADJUSTMENT: THEIR POSITIVE ASPECTS, DEFICIENCIES AND DRAWBACKS

63. Compensatory programmes were designed to offset the negative impact of adjustment on the poorest groups of a given adjusting country. After the World Bank acknowledged that some groups may be adversely affected by adjustment policies and that adjustment was not always a short process - but could turn out to be a much longer process than originally anticipated - it supported the implementation of specific measures aimed at alleviating the negative impact of adjustment on the poor. Two categories of poor were identified by the World Bank, to whom compensatory schemes should be targeted: the new poor, comprising people affected by retrenchment and who run the risk of remaining unemployed because of the contraction in public-sector employment opportunities at a time when the private sector is not yet able to absorb the laid-off workers of the public sector; and the chronically poor, a group which was poor before adjustment was initiated and who may become even poorer after the process is started (Van Der Hoeven, 1991, Stewart, 1991).

64. Programmes designed to compensate the first category of poor in 30 structural adjustment lendings undertaken between 1986 and 1989 had included: severance payments aimed at financially supporting retrenched workers until new work opportunities arise; retraining; provision of credit and resettlement of laid-off workers in agriculture (Stewart, 1991).

65. Programmes elaborated to benefit the two categories contained one or more of the following components:

(i) public works schemes and food-for-work projects for redundant workers;

(ii) credit facilities for redundant workers;

(iii) income-earning opportunities for women;

(iv) nutrition support schemes, in particular for the benefit of children and pregnant women;

(v) social expenditure reforms, including support for primary health care and the provision of educational material; and

(vi) targeted food subsidies aimed at compensating the poor when faced with cuts in subsidies. (Van Der Hoeven, 1991, Stewart, 1991)

66. The two early and best examples of comprehensive compensatory programmes in which the World Bank played an essential role were the Ghanaian PAMSCAD and the Bolivian Social Fund. These have been replicated with some changes in a number of other adjusting countries, namely Egypt, Madagascar, Guinea-Bissau, Chad, Uganda, Sao Tome and Principe, Haiti and Guatemala (Stewart, 1991).

A. Ghana's PAMSCAD

67. The Programme of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) was conceived in 1987 as part of governmental efforts to alleviate the hardship of Ghana's poorest and most marginal population groups, which had been seriously affected by successive rigorous adjustments, the first Economic Recovery Programme (ERP I) which lasted from 1983 to 1986 and the second Economic Recovery Programme (ERP II) which lasted from 1987 to 1989. Both were supported by the IMF and the World Bank. Although elaborated against the background of a long economic decline, the recession of the early 1980s and the doubling of the incidence of child malnutrition following the drought of 1983-1984, the recovery programme appears to have contributed to the worsening of the living standards and deteriorations in the quality of and accessibility to basic services by the deprived groups. Consisting of the usual package of economic reforms, with the exception that, in the particular case of this country, an increase in public expenditure was made possible through "a revival of tax revenue", the recovery programme succeeded in bringing about sustained growth of GDP of over 5 per cent per year over a five-year period. It, however, totally ignored the sacrifices that weighed upon the poor throughout its implementation, in terms of unemployment (24,000 public workers dismissed), loss of subsidies on fertilizers and introduction of charges in the educational and medical services (Stewart, 1991), to mention but a few.

68. PAMSCAD benefited from international support on the part of numerous donors favourable to reducing the social costs of adjustment and consisted of 23 anti-poverty measures designed to alleviate the plight of vulnerable groups adversely affected by adjustment. The cost of implementing these measures was estimated at $84 million over two years.

69. The target groups identified were: rural households, located in the Northern region, who had poor access to social services and income-earning opportunities, and who suffered particularly from unemployment and hunger; the low-income unemployed and underemployed urban households whose standards of living suffered from the increase in prices of some basic commodities; and retrenched workers. The anti-poverty projects included public works and food-for-work schemes designed to create employment for urban and rural unemployed and underemployed while at the same time creating or rehabilitating needed infrastructures. Other projects were promoted to meet basic needs of vulnerable groups in terms of water, sanitation (hand-dug wells and sanitation were constructed in low-cost areas), health, nutrition and shelter. Food schemes were introduced for pupils at boarding schools "easing the burden of the three-fold increase in parent's contributions following the removal of subsidies under structural adjustment" (Commonwealth Secretariat, 1991).

70. PAMSCAD was meant to be a "quick disbursing, politically popular, poverty-focused and not administratively burdensome" programme (Jolly, 1991). However, PAMSCAD suffered delays owing to administrative bottlenecks and the Government's incapacity to monitor and coordinate numerous projects involving many donors. Moreover, PAMSCAD was urban-biased (two-thirds of the funds were directed to support the urban sector while projects in the rural North, where the majority of the poor lived received only 3 per cent of the funds) and moderately succeeded in reaching the poorest: its nutrition schemes, for instance, touched a small number of malnourished infants (15,000) (for complementary information, see UNCTAD/PA/2, more specifically, pages 11, 17, 18 and 21).

B. Bolivia's Emergency Social Fund

71. Bolivia's economy was greatly affected by the collapse of the world tin market. Consequently, it experienced hyperinflation and drastic losses in GNP and per capita income. The orthodox stabilization programme launched in 1985 succeeded in curbing the annual inflation rate from 24,000 per cent in September 1985 to 11 per cent in 1987 and 21 per cent in 1988 but failed to ignite growth after five years of negative growth. The macroeconomic adjustment hurt the poor because of cutbacks in investment and government spending on social services. Massive redundancies occurred, mainly in the public sector where three quarters of the workers of the State mining company were laid off. Bolivia's Emergency Social Fund (ESF) programme was established in 1985 as a complement to a dramatic structural adjustment reform. Unlike other compensatory programmes ESF used a demand-driven approach to allocating resources, responding to proposals for projects from local and municipal governments, non-governmental organizations and grass-roots groups.

72. At the beginning, the ESF was not designed to be a comprehensive compensatory programme attempting to find solutions to problems in the social sector but rather a short-term mechanism to assist the hardest hit (by a particularly severe adjustment) until the process of sustainable growth was resumed. The programme was set up as a three-year emergency programme (later extended to four) and attracted in the first four years of its existence: "$239.5 million in foreign resources, most of which were channelled through the World Bank in the form of grants" (Graham, 1992). The main objective of its projects was to provide short-term employment and basic social services to those most affected by the austerity plan. Projects covered four broad areas: economic infrastructure, social infrastructure, social assistance, such as school-feeding schemes, and productive support for micro-enterprises, such as group credit schemes.

73. The programme employed a large number of workers from the construction sector, which was hard hit by the adjustment programme. Infrastructure created in sewerage, low-income housing, schools and health posts, etc. benefited 1.2 million people in rural and urban areas which, in a population approximating 7 million, represented a significant number (Graham, 1992) (for complementary information, see also UNCTAD/PA/2, more specifically pages 7, 20, 23 and 26).

C. Criticism of the compensatory measures and programmes

74. Many have reproached such programmes as:

- being mere "add-ons" (Reginald Herbold Green, 1991) or supplements "to mitigate the social costs of an orthodox adjustment programme" (Jolly, 1991) instead of adjustment policies being designed with built-in instruments to minimize their social costs. Compensatory programmes are complementary instruments of an overall macroeconomic policy; they do not replace it. Their success or failure depends on the extent to which restructuring strategies have taken into account the achievement of poverty reduction through an equitable redistribution of the results of the restructuring. It is the choice of policy instruments in the basic structural adjustment package, their sequencing and timing, that determine the impact of adjustment on the poor and most vulnerable. As F. Stewart states: "The fundamental deficiency in the approach is the failure to adapt macro- and much mesopolicy design in order to take into account the impact on the poor ... In particular, the speed of adjustment required, the heavy emphasis on disabsorption rather than switching, the emphasis on expenditure reduction rather than tax increases, the combination of price decontrol and wage control, the reduction/elimination of food subsidies and introduction of user charges are all elements in the basic package which cause major adverse effects. Redesign of this basic package would obviate much of the necessity for compensatory measures";

- having been organized separately from existing programmes which is generally the case for "emergency" situations. Unlike emergency schemes, compensatory programmes, in order to be really effective, should be integrated into existing programmes and allowed to profit

from the infrastructure already in place for their implementation. Existing programmes should not be allowed to die or be replaced with insufficiently developed schemes;

- having failed to narrow the targeting on the poorest of the poor who have not always been the beneficiaries of these programmes. It goes without saying that targeted programmes are more desirable than universal assistance which reaches the poor and the non-poor alike. However, a sharper focus on the poorest has not always been feasible and leakages to the non-poor have been sometimes impossible to avert. The reasons are many: first, narrow targeting implies a well-equipped administrative apparatus basing its functioning on reliable statistics and ready to engage in regular means-testing. It so happens that, in most adjusting developing countries, these elements are unfortunately missing. Secondly, narrow targeting should be, in principle, a more cost-effective exercise than universal schemes which involve heavy budgetary burdens. However, given the fact that, in some countries, universal programmes are well established, more highly focused targeting would inevitably entail a large increase in administrative costs. Thirdly, in many cases, a sharper focus on the poorest has been politically unacceptable (in India and Sri Lanka, for instance) (The Commonwealth Secretariat, 1991, Islam, 1992).

III. CONCLUSION AND ELEMENTS FOR FURTHER DISCUSSION

75. In this last section, it could be useful to identify some of the causes which may have been behind the failure of the adjustment process in its present form. It goes without saying that any suggestion to improve the current system with a view to achieving renewed strong growth which would be supplemented by economic measures converging towards a more equitable distribution of income, would, for a great part, solve the problems of the poor. Among the causes are:

(1) An insufficient investigation into the initial conditions: indeed, the careful study of the initial conditions which characterize an economy before it undergoes adjustment could play a determining role in the design of a future policy package which would adequately fit the economic and social reality of the adjusting country. The following components of an economy need to be further explored jointly by Governments and the multilateral financial institutions, before an adjustment scheme is conceived:

- the pre-adjustment growth pattern;

- the development level of an economy, whether it is middle-income or low-income makes a substantial difference. In this connection, many researchers agree that middle-income countries have been better able to sustain an adjustment process (Mosley, 1991; Woodward, 1992);

- the external conditions generating the imbalances in the national economy, for instance, the world commodities market, interest rates, etc.;

- the productive system and employment composition of the economic sectors;

- the social structure of the adjusting society, in particular localizing the poor and the poorest segments who are likely to be hardest hit by the process of adjustment;

- the land and tax systems;

- the political context.

(2) Insufficient debt reduction and insufficient external finance to support adjustment programmes: most adjusting developing countries have been caught in what is commonly called "the debt trap". Most of them have had to cope with a heavy debt burden aggravated by depleted foreign resources. The combination of these two factors has seriously undermined the implementation of reform strategies, the costs of which have unduly weighed on the most vulnerable groups. Many independent researchers, experts from international organizations, development institutes, non-governmental organizations (NGOs), and political leaders presently agree to suggest that if forgiveness of one third of the debt of middle-income countries such as Argentina or Brazil - which have the resources to pay off the remainder - and forgiveness of all the debt of the low-income countries, such as Nicaragua, Ghana, Nigeria, et al. - which cannot pay in any event - were coupled with more financial inflows to the adjusting country, the normal development process could be resumed and a more equitable sustainable growth achieved (Cheru, 1992; Mellor, 1991; Woodward, 1991; etc.).

(3) An unsustainable pace of adjustment and inadequate external financing: the pace of adjustment has been discussed by many researchers, economists and experts from NGOs. Adequate external financing and a pace of adjustment that would be sustainable are the two indispensable elements of successful adjustment. However, adequate external financing has not been forthcoming at a level sufficient for continuous adjustment efforts to inject a growth spurt into the economies of the developing countries (Van Der Hoeven, 1991).

Other sources have pointed to the fact that foreign loans have been extremely limited in recent years and the lack of resources has rendered the pace of adjustment unsustainable by the poor populations of third world countries (Woodward, 1992). As the pace of adjustment is essentially determined by the amount of the debt to be paid and the amount of external financing available, i.e. of foreign borrowing available during the structural adjustment programme, developing countries are being required to pay their debt by continuously adjusting and generating a balance of payments surplus within the time-frame set by the agreed structural adjustment programme. Many economists and experts recognize that this time-frame is not realistic and has exerted considerable pressure on the vulnerable segments of the developing societies. It was argued, therefore, that longer adjustment periods should be

allowed. This idea has more or less been accepted by the IMF and World Bank and the Second Review of Adjustment Lending by the World Bank has already indicated that periods of four to eight years should be envisaged for some economies so as to enable them to escape the vicious circle;

(4) Insufficient consideration of the impact of the international environment on the national adjusting economies, i.e. the external factors generating the imbalances in the national economy. These external factors - such as the world commodity market or the effect of promotion by adjusting countries of the same exports which may adversely affect international prices of these exports, hence, seriously deteriorating their terms of trade - should be carefully evaluated before an adjustment programme is conceived. In this connection, it is important to highlight that the problems of adjustment "lie as much in the international system as in national economies" (Woodward, 1992). Attempting to correct imbalances at the national level or to deal with the structural rigidities of the national economies only would be equivalent to ignoring a significant part of the problem;

(5) Inadequate policy packages including a combination of measures adversely affecting the populations of the adjusting developing countries: what the current orthodox policies, as advocated by the multilateral financial institutions, have failed to achieve is to adapt policy packages to the social and economic reality of the adjusting country. In order for adjustment to lead to successful results, the design of macro- and mesopolicies should fully take into account the social costs and the distributional effect of a combination of policies and accordingly, incorporate human concerns into the macroeconomic analysis (Stewart, 1991; Jolly, 1991). The following are the most noteworthy combinations:

(i) Tight fiscal policies aimed at correcting budget deficits, combined with across-the board-trade liberalization, can contribute to stifling domestic production and to increasing the incidence of poverty in a country (this is the case of many African and Latin American countries), "thus, the indiscriminate application of market principles under structural adjustment programmes would undermine the human capital foundations of economic growth and hence would increase poverty" (Commonwealth Secretariat, 1991);

(ii) A policy package, including expansion of one sector vis à vis the other, if not based on thorough knowledge of the structural composition of the local population and the distribution of its workforce, is likely to have a devastating effect on the incomes of the poor and might contribute to excluding from the production system segments of the population which may belong to the poorest and most vulnerable groups and which may even constitute the majority of the poor in a given country. For example, systematic enhancement of the agricultural sector, for the sake of improving the rural/urban terms of trade, as has been included in the policy packages of many African countries, has had the unfortunate effect of favouring large-scale farmers who produce export crops to the disadvantage of small farmers who produce food for local consumption and who constitute the majority of the poor. In general, these measures have weakened domestic food production,

food self-sufficiency, hence food security in many African countries dependent on local food production;

(iii) A policy package including devaluations and combined with price decontrol, tight fiscal and monetary policies - i.e. leading to the removal of subsidies and to increases in taxes and not accompanied by compensatory measures for the poor - may have a very destructive effect on the standards of living of the poor and the poorest.

(iv) A policy package which does not include more radical reforms of the productive system could fail to achieve an equitable distribution of the outcome of adjustment. Some adjusting countries need tax reforms, land reforms, technology reforms, etc. in order to be able to ensure that national growth and wealth are distributed equitably. Moreover, more radical reforms may not be achieved without participation at the grass-roots level.

(6) To recapitulate, the design of structural adjustment programmes in terms of policy combinations needs to take into account the reduction of absolute poverty if any results are to be attained. The negative impacts of structural adjustment programmes should not simply be offset by compensatory measures conceived as mere add-ons. Rather, structural adjustment programmes should strive to integrate poverty reduction and alleviation in the basic design of macroeconomic policies.

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